

Internal Revenue bulletin

Bulletin No. 1998-11
March 16, 1998

HIGHLIGHTS OF THIS ISSUE

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

INCOME TAX

Rev. Rul. 98-13, page 4.

Low-income housing credit; satisfactory bond; "bond factor" amounts for the period January through March 1998. This ruling announces the monthly bond factor amounts to be used by taxpayers who dispose of qualified low-income buildings or interests therein during the period January through March 1998.

Rev. Rul. 98-14, page 4.

Fringe benefits aircraft valuation formula. For purposes of section 1.61-21(g) of the Income Tax Regulations, relating to the rule for valuing noncommercial flights on employer-provided aircraft, the Standard Industry Fare Level (SIFL) cents-per-mile rates and terminal charge in effect for the first half of 1998 are set forth.

EMPLOYEE PLANS

REG-209485-86, page 21.

Proposed regulations under section 4980B of the Code provide guidance on certain changes made by the Health Insurance Portability and Accountability Act of 1996, the Omnibus Budget Reconciliation Act of 1989, and the Technical and Miscellaneous Revenue Act of 1988 relating to the continuation coverage requirements applicable to group health plans.

EXEMPT ORGANIZATIONS

Announcement 98-21, page 26.

A list is given of organizations now classified as private foundations.

EMPLOYMENT TAX

REG-104691-97, page 13.

Proposed regulations under section 6053 of the Code permit employers to establish electronic systems for their tipped employees to use to report tips to the employer.

EXCISE TAX

PS-158-86, page 13.

The proposed regulation under section 4611 of the Code relating to the petroleum tax imposed on natural gasoline is withdrawn.

ADMINISTRATIVE

Rev. Proc. 98-25, page 7.

Books and records; automatic data processing system. This procedure specifies the basic requirements that the Service considers to be essential in cases where a taxpayer's records are maintained within an Automatic Data Processing (ADP) system. Rev. Proc. 91-59 updated and superseded.

Notice 98-17, page 6.

This notice provides simplified rules under section 6038B of the Code, as amended by the Taxpayer Relief Act of 1997, on how U.S. persons should report transfers of property to foreign partnerships made between August 5, 1997, and January 1, 1998. Taxpayers may also apply the simplified rules of this notice to transfers to foreign partnerships made after August 20, 1996, and subject to the reporting requirements of section 1494(c) of the Code, so that the penalties under that section will not apply.

REG-209276-87, page 18.

Proposed regulations under section 6404 of the Code relate to the abatement of interest attributable to unreasonable errors or delays by an officer or employee of the IRS in performing a ministerial or managerial act.

Announcement 98-20, page 25.

This announcement informs all payers/transmitters, who file information returns magnetically or electronically with the IRS Martinsburg Computing Center, of a change in the record format for tax year 1998 returns filed in calendar year 1999.

Finding Lists begin on page 29.



Department of the Treasury
Internal Revenue Service

Mission of the Service

The purpose of the Internal Revenue Service is to collect the proper amount of tax revenue at the least cost; serve the public by continually improving the quality of our prod-

ucts and services; and perform in a manner warranting the highest degree of public confidence in our integrity, efficiency, and fairness.

Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he or she is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents of a permanent nature are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and proce-

dures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1986 Code.

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1986.

Part II.—Treaties and Tax Legislation.

This part is divided into two subparts as follows: Subpart A, Tax Conventions, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts. Also included in this part are Bank Secrecy Act Administrative Rulings. Bank Secrecy Act Administrative Rulings are issued by the Department of the Treasury's Office of the Assistant Secretary (Enforcement).

Part IV.—Items of General Interest.

With the exception of the Notice of Proposed Rulemaking and the disbarment and suspension list included in this part, none of these announcements are consolidated in the Cumulative Bulletins.

The first Bulletin for each month includes a cumulative index for the matters published during the preceding months. These monthly indexes are cumulated on a semiannual basis and are published in the first Bulletin of the succeeding semiannual period, respectively.

The contents of this publication are not copyrighted and may be reprinted freely. A citation of the Internal Revenue Bulletin as the source would be appropriate.

For sale by the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 42.—Low-Income Housing Credit

Low-income housing credit; satisfactory bond; “bond factor” amounts for the period January through March 1998. This ruling announces the monthly bond factor amounts to be used by taxpayers who dispose of qualified low-income buildings or interests therein during the period January through March 1998.

Rev. Rul. 98–13

In Rev. Rul. 90–60, 1990–2 C.B. 3, the Internal Revenue Service provided guidance to taxpayers concerning the general methodology used by the Treasury Department in computing the bond factor amounts used in calculating the amount of bond considered satisfactory by the Secretary under § 42(j)(6) of the Internal Revenue Code. It further announced that

the Secretary would publish in the Internal Revenue Bulletin a table of “bond factor” amounts for dispositions occurring during each calendar month.

This revenue ruling provides in Table 1 the bond factor amounts for calculating the amount of bond considered satisfactory under § 42(j)(6) for dispositions of qualified low-income buildings or interests therein during the period January through March 1998.

Table 1
Rev. Rul. 98–13
Monthly Bond Factor Amounts for Dispositions Expressed
As a Percentage of Total Credits

Calendar Year Building Placed in Service or, if Section 42(f)(1) Election Was Made, the Succeeding Calendar Year												
Month of Disposition	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998
Jan '98	63.96	79.57	81.84	84.75	88.14	91.97	95.92	99.75	103.57	107.70	111.85	112.52
Feb '98	63.96	79.57	81.59	84.49	87.86	91.67	95.59	99.39	103.18	107.25	111.28	112.52
Mar '98	63.96	79.57	81.35	84.24	87.59	91.37	95.27	99.04	102.80	106.83	110.79	112.52

For a list of bond factor amounts applicable to dispositions occurring during other calendar years, see the following revenue rulings: Rev. Rul. 95–83, 1995–2 C.B. 8, for dispositions occurring during calendar year 1995; and Rev. Rul. 98–3, 1998–2 I.R.B. 4, for dispositions occurring during the calendar years 1996 and 1997.

DRAFTING INFORMATION

The principal author of this revenue ruling is Jack Malgeri of the Office of Assistant Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue ruling, contact Mr. Malgeri at (202) 622-3040 (not a toll-free call).

Section 61.—Gross Income Defined

26 CFR 1.61–21: *Taxation of fringe benefits.*

Fringe benefits aircraft valuation formula. For purposes of section 1.61–21(g) of the Income Tax Regulations, relating to the rule for valuing noncommercial flights on employer-provided aircraft, the Standard Industry Fare Level (SIFL) cents-per-mile rates and terminal charge in effect for the first half of 1998 are set forth.

Rev. Rul. 98–14

For purposes of the taxation of fringe benefits under section 61 of the Internal Revenue Code, section 1.61–21(g) of the Income Tax Regulations provides a rule

for valuing noncommercial flights on employer-provided aircraft. Section 1.61–21(g)(5) provides an aircraft valuation formula to determine the value of such flights. The value of a flight is determined under the base aircraft valuation formula (also known as the Standard Industry Fare Level formula or SIFL) by multiplying the SIFL cents-per-mile rates applicable for the period during which the flight was taken by the appropriate aircraft multiple provided in section 1.61–21(g)(7) and then adding the applicable terminal charge. The SIFL cents-per-mile rates in the formula and the terminal charge are calculated by the Department of Transportation and are reviewed semi-annually.

The following chart sets forth the terminal charges and SIFL mileage rates:

*Period During Which
the Flight Was Taken*

1/1/98-6/30/98

*Terminal
Charge*

\$31.60

*SIFL Mileage
Rates*

Up to 500 miles = \$.1729 per mile
501-1500 miles = \$.1318 per mile
Over 1500 miles = \$.1267 per mile

DRAFTING INFORMATION

The principal author of this revenue ruling is Felicia A. Daniels of the Office of the Associate Chief Counsel (Employee Benefits and Exempt Organizations). For further information regarding this revenue ruling contact, Ms. Daniels on (202) 622-6050 (not a toll-free call).

Section 6001.—Notice or Regulations Requiring Records, Statements, and Special Returns

26 CFR 1.6001-1: Records.

What are the basic requirements that the Internal Revenue Service considers to be essential in cases where a taxpayer's records are maintained within an Automatic Data Processing (ADP) system. See Rev. Proc. 98-25, page 7.

Part III. Administrative, Procedural, and Miscellaneous

Contributions to Foreign Partnerships Under Section 6038B

Notice 98-17

This Notice provides simplified rules (pending the issuance of regulations) for reporting the transfer of property by U.S. persons to foreign partnerships under section 6038B of the Internal Revenue Code (the Code), as amended by the Taxpayer Relief Act of 1997 (the 1997 Act). The Notice applies to transfers made after August 5, 1997 and before January 1, 1998. Taxpayers may also apply the simplified rules of this Notice to transfers to foreign partnerships made after August 20, 1996 and subject to the reporting requirements of section 1494(c), so that the penalties under that section shall not apply.

SECTION 1. BACKGROUND

A. Sections 1491-1494

Before its repeal, section 1491 imposed a 35 percent excise tax on a transfer of property ("section 1491 transfer") by a U.S. person to a foreign partnership (unless section 1492 applied). The excise tax was 35 percent of the excess of the fair market value of the property transferred over its adjusted basis plus any gain recognized to the transferor upon the transfer.

In 1996, section 1494(c) was enacted, adding a penalty (even if no excise tax was due) for failure to file a return reporting a section 1491 transfer made after August 20, 1996. Sections 1491-1494 were repealed by the 1997 Act, effective August 5, 1997.

B. Notices 97-18 and 97-42

Notice 97-18, 1997-10 I.R.B. 35, issued after enactment of section 1494(c) and before its repeal, excluded certain section 1491 transfers from the reporting requirement and provided that no penalty would be imposed under section 1494(c) with respect to a section 1491 transfer if a Form 926 reporting such transfer was filed by the date specified in that notice.

Notice 97-42, 1997-29 I.R.B. 12, also issued after enactment of section 1494(c) and before its repeal, extended the due date for filing Form 926 to report section

1491 transfers made during the taxable year that included August 20, 1996, to the due date (including extensions) of the transferor's timely-filed income tax return or information return for the first taxable year beginning on or after January 1, 1997.

C. Section 6038B as amended by the 1997 Act

The 1997 Act amended section 6038B to require that certain transfers by U.S. persons to foreign partnerships be subject to reporting under section 6038B. These transfers are contributions described in section 721 ("section 721 contributions") and any other contributions described in regulations. Under section 6038B(b)(1), this reporting is required only if: 1) the transferor holds (immediately after the transfer) directly or indirectly at least a 10 percent interest in the partnership, or 2) the fair market value of the property transferred (alone, or aggregated with certain other section 721 contributions) exceeds \$100,000.

SECTION 2. SECTION 6038B REPORTING FOR TRANSFERS MADE AFTER AUGUST 5, 1997 AND BEFORE JANUARY 1, 1998

Section 721 contributions to foreign partnerships made after August 5, 1997 and before January 1, 1998 and required to be reported under section 6038B shall be reported by the filing of Form 926 with Part I of the form completed and the information required in this Section 2 attached. Form 926 and its attachments must be filed with the transferor's tax return or information return for the taxable year that includes the date of transfer. The notation "Filed under Notice 98-17" should be marked at the top of the form.

A U.S. person that contributes to a foreign partnership appreciated property subject to the allocation rules of section 704(c) (property with built-in gain), or any intangible property, in a transfer subject to section 6038B, must separately identify the property (except to the extent that the property is permitted to be aggregated in making allocations under section 704(c)). A U.S. person that contributes built-in gain property must also indicate the foreign partnership's method of allo-

cating the built-in gain under section 704(c).

The value of other contributed property must be aggregated by category on a statement attached to Form 926 (with, in each case, a brief description of the property). The categories are:

- (1) Stock in trade of the transferor (inventory);
- (2) Tangible property (other than stock in trade) used in a trade or business of the transferor;
- (3) Cash, stock, notes receivable and payable, and other securities; and,
- (4) Other property.

Until further notice, taxpayers transferring property to partnerships will be required to report under section 6038B only section 721 contributions. Any guidance exercising the authority to require the reporting of other contributions will be prospective only. Additionally, Section 761(a) allows certain organizations that would otherwise be treated as partnerships to elect not to be treated as partnerships for purposes of subchapter K of the Code. Until further notice, any transfer to a foreign partnership with a valid section 761(a) election in effect will not be required to be reported under section 6038B.

SECTION 3. RELIEF FROM SECTION 1494 REPORTING

Section 1144(d)(2) of the 1997 Act provides that the section 1494(c) penalty will not apply to any transfers which would otherwise be subject to the penalty, if taxpayers comply with the reporting requirements of amended section 6038B or such simplified reporting requirements as the Secretary may prescribe. In order to avoid any section 1494(c) penalty which otherwise would apply in respect of transfers to foreign partnerships, taxpayers need only comply with the simplified reporting requirements provided in Section 2, above. Furthermore, section 721 contributions need only be reported by taxpayers described in section 6038B(b)(1).

A transfer to a foreign partnership may consist solely of property which would not be required to be reported under section 6038B and this Notice, but which is required to be reported under section

1494 and Notice 97-18. Taxpayers need not report such transfers to avoid penalties under section 1494(c). However, in such cases, at their option, taxpayers may file a Form 926 with the notation "Filed under Notice 98-17—no reportable transfers" at the top of the form.

This Notice does not affect any obligation under section 1494 to report transfers to foreign entities other than foreign partnerships. Also, if a transfer to a foreign partnership was subject to the excise tax under section 1491, the tax must still be paid and the transfer reported on Form 926. If the excise tax does not otherwise apply by reason of section 1492, the taxpayer must still comply with all applicable requirements of that section. Finally, a U.S. person that is required to report under section 1494 and does not comply with the reporting requirements of this Notice remains subject to penalties under section 1494(c).

SECTION 4. EFFECTIVE DATES

This Notice is effective for transfers made after August 5, 1997 and before January 1, 1998. The Form 926 reporting such transfers must be filed with the transferor's timely-filed (including extensions) income tax return or information return for the period in which the transfers occur. Transferors choosing to report under these rules in respect of transfers subject to section 1494(c), must file a Form 926 including the information required by this Notice with their return for the first taxable year beginning on or after January 1, 1997 (the reporting deadline under Notice 97-42).

SECTION 5. PAPERWORK REDUCTION ACT

The collections of information contained in this Notice have been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-1586.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number.

The collections of information contained in this Notice are in Sections 2 and 3. The information is required to determine if gain and income from property

transferred to foreign partnerships is correctly taxed to U.S. transferors. The information will be used for the purpose described in the preceding sentence. The collections of information are required to obtain a benefit. The likely respondents are businesses or other for-profit institutions, individuals, and not-for-profit institutions.

The estimated total annual reporting and/or recordkeeping burden is 250 hours.

The estimated annual burden per respondent/recordkeeper varies from 0.25 hours to 1.0 hours, with an average burden of 0.5 hours. The estimated number of respondents and/or recordkeepers is 500.

The estimated frequency of responses (used for reporting requirements only) is once per year.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

DRAFTING INFORMATION

The principal author of this notice is Robert Lorence of the Office of Associate Chief Counsel (International). For further information regarding this notice, contact Mr. Lorence at (202) 622-3860 (not a toll-free call).

26 CFR 601.105: Examination of returns and claims for refund, credits or abatement; determination of correct tax liability. (Also Part I, Section 6001; 1.6001-1.)

Rev. Proc. 98-25

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SECTION 1. PURPOSE

The purpose of this revenue procedure is to specify the basic requirements that the Internal Revenue Service considers to be essential in cases where a taxpayer's records are maintained within an Automatic Data Processing system (ADP). This revenue procedure updates and supersedes Rev. Proc. 91-59, 1991-2 C.B. 841.

SECTION 2. BACKGROUND

.01 Section 6001 provides that every person liable for any tax imposed by the Code, or for the collection thereof, must keep such records, render such statements, make such returns, and comply with such rules and regulations as the Secretary may from time to time prescribe. Whenever necessary, the Secretary may require any person, by notice served upon that person or by regulations, to make such returns, render such statements, or keep such records, as the Secretary deems sufficient to show whether or not that person is liable for tax.

.02 Section 1.6001-1(a) of the Income Tax Regulations generally provides that persons subject to income tax, or required to file a return of information with respect to income, must keep such books or records, including inventories, as are sufficient to establish the amount of gross income, deductions, credits, or other matters required to be shown by that person in any return of such tax or information.

.03 Section 1.6001-1(e) provides that the books or records required by § 6001 must be kept available at all times for inspection by authorized internal revenue officers or employees, and must be retained so long as the contents thereof may become material in the administration of any internal revenue law.

.04 Rev. Rul. 71-20, 1971-1 C.B. 392, establishes that all machine-sensible data media used for recording, consolidating, and summarizing accounting transactions

and records within a taxpayer's ADP system are records within the meaning of § 6001 and § 1.6001-1, and are required to be retained so long as the contents may become material in the administration of any internal revenue law.

SECTION 3. SCOPE

.01 *Records.*

(1) The requirements of this revenue procedure pertain to all matters under the jurisdiction of the Commissioner of Internal Revenue including, but not limited to, income, excise, employment, and estate and gift taxes, as well as employee plans and exempt organizations.

(2) The requirements of this revenue procedure are applicable to any sections of the Code that have unique or specific recordkeeping requirements. For example, machine-sensible records maintained by the taxpayer to meet the requirements of § 274(d) relating to the amount, time, place, and business purpose of a business expense must meet the requirements of this revenue procedure.

(3) Except as otherwise provided in this revenue procedure, all requirements of § 6001 that apply to hardcopy books and records apply as well to machine-sensible books and records that are maintained within an ADP system.

.02 *Taxpayers.*

(1) A taxpayer with assets of \$10 million or more at the end of its taxable year must comply with the record retention requirements of Rev. Rul. 71-20 and the provisions of this revenue procedure. For purposes of this revenue procedure, a controlled group of corporations, as defined in § 1563, is considered to be one corporation and all assets of all members of the group are aggregated.

(2) A taxpayer with assets of less than \$10 million at the end of its taxable year must comply with the record retention requirements of Rev. Rul. 71-20 and the provisions of this revenue procedure if any of the following conditions exists:

(a) all or part of the information required by § 6001 is not in the taxpayer's hardcopy books and records, but is available in machine-sensible records;

(b) machine-sensible records were used for computations that cannot be reasonably verified or recomputed without using a computer (*e.g.*, Last-In, First-Out (LIFO) inventories); or

(c) the taxpayer is notified by the District Director that machine-sensible records must be retained to meet the requirements of § 6001.

(3) A Controlled Foreign Corporation (CFC), a domestic corporation that is 25 percent foreign-owned, and a foreign corporation engaged in a trade or business within the United States at any time during a taxable year that maintains machine-sensible records within an ADP system must comply with the requirements of this revenue procedure to satisfy the recordkeeping requirements of §§ 964(c), 982(d), 6038A(c)(4), and 6038C (and the regulations thereunder).

(4) An insurance company that maintains machine-sensible records within an ADP system to determine losses incurred under § 832(b)(5) must comply with the requirements of this revenue procedure and Rev. Proc. 75-56, 1975-2 C.B. 596. For this purpose, the machine-sensible records for a particular taxable year include the records for that year and the seven preceding years, all of which must be retained so long as they may become material to the examination of an insurance company's federal tax return.

(5) A taxpayer's use of a third party (such as a service bureau, time-sharing service, value-added network, or other third party service) to provide services (*e.g.*, custodial or management services) in respect of machine-sensible records does not relieve the taxpayer of its recordkeeping obligations and responsibilities under § 6001 and this revenue procedure.

SECTION 4. DEFINITIONS

.01 An "ADP system" consists of an accounting and/or financial system (and subsystems) that processes all or part of a taxpayer's transactions, records, or data by other than manual methods. An ADP system includes, but is not limited to, a mainframe computer system, stand-alone or networked microcomputer system, Data Base Management System (DBMS), and a system that uses or incorporates Electronic Data Interchange (EDI) technology or an electronic storage system.

.02 "Capable of being processed" means the ability to retrieve, manipulate, print on paper (hardcopy), and produce output on electronic media. This term does not encompass any requirement that the program or system that created the

computer data be available to process the data unless that program or system is necessary to:

(1) a tax-related computation (*e.g.*, LIFO inventories, insurance company loss reserve computations, and foreign tax credit computations); or

(2) the retrieval of data (*e.g.*, some data base systems processes where the taxpayer chooses not to create a sequential extract (see section 5.02 of this revenue procedure)).

.03 A "DBMS" is a software system that creates, controls, relates, retrieves, and provides accessibility to data stored in a data base.

.04 "EDI technology" is the computer-to-computer exchange of business information.

.05 An "electronic storage system" is a system used to prepare, record, transfer, index, store, preserve, retrieve, and reproduce books and records by either: (1) electronically imaging hardcopy documents to an electronic storage media; or (2) transferring computerized books and records to an electronic storage media using a technique such as "COLD" (computer output to laser disk), which allows books and records to be viewed or reproduced without the use of the original program. See Rev. Proc. 97-22, 1997-13 I.R.B. 9, for electronic storage system requirements.

.06 A "machine-sensible record" is data in an electronic format that is intended for use by a computer. Machine-sensible records do not include paper records or paper records that have been converted to an electronic storage medium such as microfilm, microfiche, optical disk, or laser disk.

SECTION 5. RETAINING MACHINE-SENSIBLE RECORDS

.01 *General.*

(1) The taxpayer must retain machine-sensible records so long as their contents may become material to the administration of the internal revenue laws under § 1.6001-1(e). At a minimum, this materiality continues until the expiration of the period of limitation for assessment, including extensions, for each tax year. In certain situations, records should be kept for a longer period of time. For example, records that pertain to fixed assets, losses incurred under § 832(b)(5), and LIFO in-

ventories should be kept for longer periods of time.

(2) The taxpayer's machine-sensible records must provide sufficient information to support and verify entries made on the taxpayer's return and to determine the correct tax liability. The taxpayer's machine-sensible records will meet this requirement only if they reconcile with the taxpayer's books and the taxpayer's return. A taxpayer establishes this reconciliation by demonstrating the relationship (i.e., audit trail):

(a) between the total of the amounts in the taxpayer's machine-sensible records by account and the account totals in the taxpayer's books; and

(b) between the total of the amounts in the taxpayer's machine-sensible records by account and the taxpayer's return.

(3) The taxpayer must ensure that its machine-sensible records contain sufficient transaction-level detail so that the information and the source documents underlying the machine-sensible records can be identified.

(4) All machine-sensible records required to be retained by this revenue procedure must be made available to the Service upon request and must be capable of being processed.

(5) Except as otherwise required by sections 5.01(2) or (3) of this revenue procedure, a taxpayer is not required to create any machine-sensible record other than that created either in the ordinary course of its business or to establish return entries. For example, a taxpayer who does not create, in the ordinary course of its business, the electronic equivalent of a traditional paper document (such as an invoice) is not required by this revenue procedure to construct such a record, provided that the requirements of sections 5.01(2) and (3) are met. For requirements relating to hardcopy records, see section 11 of this revenue procedure.

(6) A taxpayer's disposition of a subsidiary company does not relieve the taxpayer of its responsibilities under this revenue procedure. The files and documentation retained for the Service by, or for, a disposed subsidiary must be retained as otherwise required by this revenue procedure.

.02 DBMS.

(1) A taxpayer has the discretion to

create files solely for the use of the Service. For example, a taxpayer that uses a DBMS may satisfy the provisions of this revenue procedure by creating and retaining a sequential file that contains the transaction-level detail from the DBMS and otherwise meets the requirements of this revenue procedure.

(2) A taxpayer that creates a file described in section 5.02(1) of this revenue procedure must document the process that created the sequential file in order to establish the relationship between the file created and the original DBMS records.

.03 EDI.

(1) A taxpayer that uses EDI technology must retain machine-sensible records that alone, or in combination with any other records (e.g., underlying contracts, price lists, and price changes), contain all the information that § 6001 requires of hardcopy books and records. For example, a taxpayer that uses EDI technology receives electronic invoices from its suppliers. The taxpayer decides to retain the invoice data from completed and verified EDI transactions in its accounts payable system rather than retain the incoming EDI transactions. Neither the EDI transactions, nor the accounts payable system, contain product descriptions or vendor names. To satisfy the requirements of § 6001, the taxpayer must supplement its EDI records with product code description lists and a vendor master file.

(2) A taxpayer may capture the required detail for an EDI transaction at any level within its accounting system. However, the taxpayer must establish audit trails between the retained records and the taxpayer's books, and between the retained records and the tax return.

(3) Section 11.02 of this revenue procedure provides additional guidance concerning hardcopy requirements related to EDI transactions.

SECTION 6. DOCUMENTATION

.01 The taxpayer must maintain and make available to the Service upon request documentation of the business processes that:

- (1) create the retained records;
- (2) modify and maintain its records;
- (3) satisfy the requirement of section 5.01(2) of this revenue procedure to support and verify entries made on the tax-

payer's return and determine the correct tax liability; and

(4) evidence the authenticity and integrity of the taxpayer's records.

.02 The documentation described in section 6.01 of this revenue procedure must be sufficiently detailed to identify:

(1) the functions being performed as they relate to the flow of data through the system;

(2) the internal controls used to ensure accurate and reliable processing;

(3) the internal controls used to prevent the unauthorized addition, alteration, or deletion of retained records; and

(4) the charts of accounts and detailed account descriptions.

.03 With respect to each file that is retained, the taxpayer must maintain, and make available to the Service upon request, documentation of:

(1) record formats or layouts;

(2) field definitions (including the meaning of all "codes" used to represent information);

(3) file descriptions (e.g., data set name);

(4) evidence that periodic checks (described in section 9.01(3) of this revenue procedure) of the retained records were performed to meet section 9.02(1) of this revenue procedure, if the taxpayer wants to take advantage of section 9.02 of this revenue procedure;

(5) evidence that the retained records reconcile to the taxpayer's books; and

(6) evidence that the retained records reconcile to the taxpayer's tax return.

.04 The system documentation must include any changes to the items specified in sections 6.01, 6.02, and 6.03 of this revenue procedure and the dates these changes are implemented.

SECTION 7. RESOURCES

.01 The taxpayer must provide the Service at the time of an examination with the resources (e.g., appropriate hardware and software, terminal access, computer time, personnel, etc.) that the District Director determines is necessary to process the taxpayer's machine-sensible books and records. At the request of the taxpayer, the District Director may, at the District Director's discretion:

(1) identify the taxpayer's resources that are not necessary to process books and records;

(2) allow a taxpayer to convert machine-sensible records to a different medium (e.g., from mainframe files to microcomputer diskette(s));

(3) allow the taxpayer to satisfy the processing needs of the Service during off-peak hours; and

(4) allow the taxpayer to provide the Service with third-party equipment.

.02 An ADP system must not be subject, in whole or in part, to any agreement (such as a contract or license) that would limit or restrict the Service's access to and use of the ADP system on the taxpayer's premises (or any other place where the ADP system is maintained), including personnel, hardware, software, files, indexes, and software documentation.

SECTION 8. NOTIFICATION

.01 Except as provided in section 9.02 of this revenue procedure, the taxpayer must promptly notify its District Director if any machine-sensible records are lost, stolen, destroyed, damaged, or otherwise no longer capable of being processed (as defined in section 4.02 of this revenue procedure), or are found to be incomplete or materially inaccurate (affected records).

.02 The taxpayer's notice must identify the affected records and include a plan that describes how, and in what time-frame, the taxpayer proposes to replace or restore the affected records in a way that assures that they will be capable of being processed. The plan must demonstrate that all of the requirements of this revenue procedure will continue to be met with respect to the affected records.

.03 The District Director will notify the taxpayer of any objection(s) to the taxpayer's plan.

.04 A District Director may consider, whenever warranted by the facts and circumstances, the possibility of requiring less than a total restoration of missing data.

.05 Examples.

(1) Taxpayer A replaces its general ledger software system with a new general ledger software system with which the original system's records are incompatible. However, A's original records are retrievable and capable of being processed on A's hardware system. A is not required to notify its District Director of the

change in its software system because A's records remain capable of being processed.

(2) Taxpayer B replaces its original ADP hardware system with a new system that cannot process the machine-sensible records created and maintained by B's original system. B must notify its District Director of this hardware system change and propose a plan for assuring that the machine-sensible records created and maintained by the original ADP hardware system are capable of being processed. To that end, B considers the following options: (1) having all records in the taxpayer's original system immediately reformatted so that the new system can retrieve and process those records; (2) having all records in its original system reformatted by a designated future date; or (3) having an arrangement with a third party to process all records in its original system on a compatible system. Any of these options may be acceptable provided the option selected enables the taxpayer to meet the requirements of this revenue procedure with respect to those records. The taxpayer must be able to demonstrate that any third party reformatting or processing is done with the quality controls in place that will ensure the continued integrity, accuracy, and reliability of the taxpayer's records.

SECTION 9. MAINTENANCE

.01 Recommended Practices.

(1) The implementation of records management practices is a business decision that is solely within the discretion of the taxpayer. Recommended records management practices include the labeling of records, providing a secure storage environment, creating back-up copies, selecting an offsite storage location, and testing to confirm records integrity.

(2) The National Archives and Record Administration's (NARA) Standards for the Creation, Use, Preservation, and Disposition of Electronic Records, 36 C.F.R., Ch XII, Part 1234, Subpart C (1996), is one example of a records management resource that a taxpayer may choose to consult when formulating its records management practices.

(3) The NARA standard in 36 C.F.R. § 1234.30(g)(4) (1996) requires an annual reading of a statistical sampling of magnetic computer tape reels to identify any

loss of data and to discover and correct the causes of data loss. In libraries with 1,800 or fewer storage units (e.g., magnetic tape reels), a 20 percent random sampling or a sample size of 50 units, whichever is larger, should be read. In libraries with more than 1,800 units, a sample of 384 units should be read. Although this NARA sampling standard is specifically for magnetic computer tape, the Service recommends that all retained machine-sensible records be sampled and tested as described in the NARA standard.

.02 *Partial Loss of Data.* A taxpayer that loses only a portion of the data from a particular storage unit will not be subject to the penalties described in section 12 of this revenue procedure if the taxpayer can demonstrate to the satisfaction of the District Director that the taxpayer's data maintenance practices conform with 36 C.F.R. § 1234.30(g)(4) (1996) (the NARA sampling standard). However, the taxpayer remains responsible for substantiating the information on its return as required by § 6001.

SECTION 10. DISTRICT DIRECTOR AUTHORITY

.01 Record Retention Limitation Agreement.

(1) A taxpayer who maintains machine-sensible records may request to enter into a Record Retention Limitation Agreement (RRLA) with its District Director. This agreement provides for the establishment and maintenance of records as agreed upon by the District Director and the taxpayer.

(2) The taxpayer's request must identify and describe those records the taxpayer proposes not to retain and explain why those records will not become material to the administration of any internal revenue law. The District Director will notify the taxpayer whether or not the District Director will enter into an RRLA.

(3) In an RRLA, the District Director may waive all or any of the specific requirements in this revenue procedure. A taxpayer remains subject to all the requirements in this revenue procedure that are not specifically modified or waived by an RRLA.

(4) Unless an RRLA otherwise specifies, an RRLA shall not apply to accounting and tax systems added subsequent to the completion of the record evaluation

upon which the agreement is based. All machine-sensible records produced by a subsequently added accounting and tax system, the contents of which may be or may become material in the administration of the Code must be retained by the taxpayer signing the RRLA until a new evaluation is conducted by the District Director.

(5) Unless an RRLA specifies otherwise, it does not apply to a subsidiary acquired subsequent to the completion of the record evaluation upon which the RRLA is based. All machine-sensible records produced by the acquired subsidiary, the contents of which may be or may become material in the administration of the Code must be retained pursuant to this revenue procedure and any pre-acquisition RRLA ("former RRLA") that applies to the acquired subsidiary. The former RRLA applies to the acquired subsidiary until the District Director either revokes the former RRLA (in whole or in part) or enters into a new RRLA that applies to the acquired subsidiary.

(6) Upon the disposition of a subsidiary, the files being retained for the Service pursuant to an RRLA by, or for, the disposed subsidiary must be retained by the taxpayer until a new evaluation is conducted by the District Director.

(7) A District Director's decision to revoke an RRLA, or not to enter into an RRLA, does not relieve the taxpayer of its recordkeeping obligations under § 6001 or its responsibilities described in this revenue procedure.

.02 Records Evaluation.

(1) The District Director may conduct a records evaluation at any time the District Director deems it appropriate to review the taxpayer's record retention practices, including the taxpayer's relevant data processing and accounting systems.

(2) The records evaluation described in section 10.02(1) of this revenue procedure is not an "examination", "investigation", or "inspection" of the books and records within the meaning of § 7605(b) of the Code, or a prior audit for purposes of § 530 of the Revenue Act of 1978, 1978-3 (Vol. 1) C.B. 119, as amended by § 1122 of the Small Business Job Protection Act of 1996, because this evaluation is not directly related to the determination of the tax liability of a taxpayer for a particular taxable period.

(3) The District Director will inform the taxpayer of the results of a records evaluation.

.03 Testing.

(1) The District Director may periodically initiate tests to establish the authenticity, readability, completeness, and integrity of a taxpayer's machine-sensible records retained in conformity with this revenue procedure.

(2) These tests may include a review of integrated systems such as EDI or an electronic storage system, and a review of the internal controls and security procedures associated with the creation and maintenance of the taxpayer's records.

(3) The tests described in section 10.03(1) of this revenue procedure are not an "examination", "investigation", or "inspection" of the books and records within the meaning of § 7605(b) of the Code, or a prior audit for purposes of § 530 of the Revenue Act of 1978, 1978-3 (Vol. 1) C.B. 119, as amended by § 1122 of the Small Business Job Protection Act of 1996, because these tests are not directly related to the determination of the tax liability of a taxpayer for a particular taxable period.

(4) The District Director will inform the taxpayer of the results of these tests.

SECTION 11. HARDCOPY RECORDS

.01 The provisions of this revenue procedure do not relieve taxpayers of their responsibility to retain hardcopy records that are created or received in the ordinary course of business as required by existing law and regulations. Hardcopy records may be retained in microfiche or microfilm format in conformity with Rev. Proc. 81-46, 1981-2 C.B. 621. Hardcopy records may also be retained in an electronic storage system in conformity with Rev. Proc. 97-22. These records are not a substitute for the machine-sensible records required to be retained by this revenue procedure.

.02 A taxpayer need not create or retain hardcopy records if:

(1) the hardcopy records are merely computer printouts created only for validation, control, or other temporary purposes;

(2) the hardcopy records are not produced in the ordinary course of transacting business (as may be the case when utilizing EDI technology); or

(3) all the details relating to the transaction are subsequently received by the taxpayer in an EDI transaction and are retained as machine-sensible records by the taxpayer in conformity with this revenue procedure. For example, a taxpayer need not retain credit card receipts generated at the time of a transaction if all pertinent information on the receipts is subsequently received in an EDI transaction and retained as a machine-sensible record. See section 5.03 of this revenue procedure for requirements relating to EDI.

.03 A taxpayer need not create hardcopy printouts of its machine-sensible records unless requested to do so by the Service. The Service may request such hardcopy printouts either at the time of an examination or in conjunction with the tests described in section 10.03(1) of this revenue procedure.

SECTION 12. PENALTIES

The District Director may issue a Notice of Inadequate Records pursuant to § 1.6001-1(d) if a taxpayer fails to comply with this revenue procedure (including a failure to satisfy the resource requirements of section 7 of this revenue procedure). Failure to comply with this revenue procedure may also result in the imposition of the applicable penalties under subtitle F of the Code, including the § 6662(a) accuracy-related civil penalty and the § 7203 willful failure criminal penalty.

SECTION 13. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 91-59 is modified and superseded for machine-sensible records relating to taxable years beginning after December 31, 1997. However, a taxpayer that complies with this revenue procedure for taxable years beginning prior to that date is treated as having complied with Rev. Proc. 91-59 for those years.

SECTION 14. EFFECTIVE DATE

This revenue procedure is effective for machine-sensible records relating to taxable years beginning after December 31, 1997.

SECTION 15. INTERNAL REVENUE SERVICE OFFICE CONTACT

.01 Questions regarding this revenue procedure should be directed to the Office

of the Assistant Commissioner (Examination). The telephone number for this office is (202)622-5480 (not a toll-free number). Written questions should be addressed to: Assistant Commissioner (Examination)

Attention: CP:EX
Internal Revenue Service
1111 Constitution Ave., NW
Washington, DC 20224

.02 Questions regarding the application of this revenue procedure to a specific factual situation should be directed to the appropriate District Director's office.

SECTION 16. PAPERWORK REDUCTION ACT

The collections of information contained in this revenue procedure have

been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-1595.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number.

The collections of information in this revenue procedure are in sections 8 and 10 of this revenue procedure. This information is required to ensure that machine-sensible records will constitute records within the meaning of § 6001. The collections of information are mandatory for a taxpayer whose machine-sensible records are kept within an ADP system. The likely respondents are individuals,

state or local governments, farms, business or other for-profit institutions, federal agencies or employees, nonprofit institutions, and small businesses or organizations.

The estimated total annual recordkeeping burden is 120,000 hours.

The estimated annual burden per recordkeeper will vary from 20 hours to 60 hours, depending on individual circumstances, with an estimated average of 40 hours. The estimated number of recordkeepers is 3,000.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Part IV. Items of General Interest

Withdrawal of Notice of Proposed Rulemaking

Petroleum Tax Imposed on Natural Gasoline

PS-158-86

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Withdrawal of notice of proposed rulemaking.

SUMMARY: This document withdraws a proposed regulation relating to the petroleum tax imposed on natural gasoline. The withdrawal affects persons that produce natural gasoline at fractionation facilities or receive natural gasoline produced at those facilities.

FOR FURTHER INFORMATION CONTACT: Ruth Hoffman, (202) 622-3130 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

Section 4611 imposed a tax on crude oil (including natural gasoline) received at a United States refinery. On April 26, 1993, a notice of proposed rulemaking (PS-158-86 [1993-1 C.B. 866]) relating to this tax was published in the **Federal Register** (58 F.R. 21963). The proposed regulation treats any facility that produces natural gasoline by fractionation or similar operation as a United States refinery. Under this rule, tax would be imposed on natural gasoline when it is produced from natural gas liquids at a fractionation facility.

Since the publication of the proposed regulation, the tax imposed by section 4611 has expired. Because tax is not currently imposed under section 4611, the proposed regulation is being withdrawn. For purposes of section 4611 prior to its expiration, the IRS will follow the result in *Enron Gas Processing Co. v. United States*, 96-1 USTC ¶ 70,058 (S.D. Tex. 1996), in all cases involving substantially similar facts. In *Enron*, the U.S. District Court for the Southern District of Texas held that fractionation facilities are not United States refineries.

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Withdrawal of Notice of Proposed Rulemaking

Accordingly, under the authority of 26 U.S.C. 7805, the notice of proposed rulemaking that was published in the **Federal Register** on April 26, 1993 (58 F.R. 21963) is withdrawn.

Michael P. Dolan,
*Deputy Commissioner of
Internal Revenue.*

(Filed by the Office of the Federal Register on December 22, 1997, 8:45 a.m., and published in the issue of the Federal Register for December 23, 1997, 62 F.R. 67013)

Notice of Proposed Rulemaking

Electronic Tip Reports

REG-104691-97

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document proposes to amend the regulations dealing with the requirement that tipped employees report their tips to their employer. The proposed regulations permit employers to establish electronic systems for use by their tipped employees in reporting tips to the employer. The proposed regulations also address substantiation requirements for employees using the electronic system.

DATES: Written comments and requests for a public hearing must be received by April 27, 1998.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG-104691-97), room 5228, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG-104691-97), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home

Page, or by submitting comments directly to the IRS Internet site at http://www.irs.ustreas.gov/prod/tax_reggs/comments.html.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Karin Loverud, 202-622-6060; concerning submissions, Evangelista Lee, 202-622-8452 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in this notice of proposed rulemaking has been submitted to the **Office of Management and Budget** for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information should be sent to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, T:FP, Washington, DC 20224. Comments on the collection of information should be received by March 27, 1998. Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the functions of the **Internal Revenue Service**, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information (see below);

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collection of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of service to provide information.

The collections of information in this proposed regulation are in §31.6053-1 and §31.6053-4. This information is required to conform with the statute and to

assist employers and employees in fulfilling their responsibilities. This information will be used by employers to establish the amount of income and FICA (or RRTA) taxes to withhold from the employee reporting the tips. This information will be used by employees in meeting the substantiation requirements. The collections of information are mandatory. The likely respondents are individuals.

Estimated total annual reporting burden: 600,000 hours.

Estimated average annual burden hours per respondent: 2 hours.

Estimated number of respondents: 300,000.

Estimated annual frequency of responses: varies.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

This document contains proposed amendments to the Employment Tax Regulations (26 CFR part 31) under section 6053(a) of the Internal Revenue Code (Code). The proposed regulations provide rules permitting employers to establish electronic systems for use by their tipped employees in reporting tips to the employer.

In general, under section 6053(a) of the Code, every employee who receives tips must report the tips to the employer. The tips that must be reported are those that are wages for purposes of federal income tax withholding and the Federal Insurance Contributions Act (FICA) and compensation for purposes of the Railroad Retirement Tax Act (RRTA). The tips must be reported in a written statement or statements furnished to the employer on or before the 10th day following the month in which the tips are received. The Secretary is authorized to prescribe rules necessary to implement this provision, including the form and manner of furnishing the statements.

Generally, all cash tips (which include tips that are charged) are wages (or compensation), with one exception. If the amount of cash tips received in a calendar month by an employee in the course of any one employment is less than \$20, the cash tips received in that employment during that month are not wages subject to income tax withholding, FICA taxes, or RRTA taxes.

For example, A is a full-time tipped employee of X and a part-time tipped employee of Y. During the month, A received \$1,000 in tips in A's employment with X and \$10 in tips in A's employment with Y. The \$1,000 in tips received in the course of employment with X are wages for income tax withholding and FICA (or RRTA) tax purposes. A must report the \$1,000 in tips to X no later than the 10th day of the following month. The \$10 in tips received in the course of employment with Y are not wages for those purposes. The \$10 are, however, subject to federal income tax and must be reported as wages by the employee on Form 4137, *Social Security and Medicare Tax on Unreported Tip Income*, which the employee must file with Form 1040, *U.S. Individual Income Tax Return*.

Section 31.6053-1(b)(1) prescribes rules for tip statements. The statement furnished by the employee to the employer must be in writing and must be signed by the employee. The statement must disclose (1) the employee's name, address, and social security number; (2) the employer's name and address; (3) the period for which and the date on which the statement is furnished; and (4) the total amount of tips received by the employee during the period that are required to be reported to the employer.

Under §31.6053-1(b)(2), no particular form is prescribed for use in furnishing the tip statement. If the employer does not provide a form for use by the employee in reporting tips received by the employee, the employee may use Form 4070, *Employee's Report of Tips to Employer*. Twelve blank Forms 4070 and 12 blank Forms 4070A, *Employee's Daily Record of Tips* are reproduced in Publication 1244, *Employee's Daily Record of Tips and Report to Employer*. (Daily completion of Form 4070A constitutes sufficient evidence of tip income under the substantiation requirements of

§31.6053-4.) Pub. 1244 is a convenient pocket-sized document that also includes the basic rules for reporting tips. Copies of Pub. 1244 are available from the IRS by calling 1-800-829-3676.

The regulations specifically permit employers to design their own forms for use by employees in reporting tips. A form used solely to report tips must include (1) the employee's name, address, and social security number; (2) the employer's name and address; (3) the period for which and the date on which the statement is furnished; and (4) the total amount of tips received by the employee during the period that are required to be reported to the employer.

In lieu of a special tip reporting form that is used solely for the purpose of reporting tips, employers may provide for reporting of tips on regularly used forms, such as time cards. The regularly used forms need not include the employer information, but they must accurately identify the employee, identify the reporting period, and specify the amount of tips received. If a regularly used form is used to report tips, the employer must furnish the employee a statement showing the amount of tips reported by the employee for the period. This statement must be furnished no later than shortly after the first wage payment following the employee's tip report. A payroll check stub or other similar payroll document may be used for this purpose.

The period covered by a tip statement may not exceed one calendar month. An employer may require tip statements more frequently, such as daily, weekly or every pay period, if not less frequently than monthly. In no event, however, may an employer permit tips received in one month to be reported after the 10th of the following month. See section 6053(a). For example, X has a weekly payroll period, beginning on Sunday and ending on Saturday. X requires that all tip statements be submitted to X no later than the Monday following each payroll period. For the payroll period beginning on Sunday, March 30, and ending on Saturday, April 5, the statements must be furnished on or before Monday, April 7. If this occurs, the 10th-of-the-month requirement for March is met. If X's payroll period were biweekly and began on March 30 and ended on April 16 and if X required

that all tip statements be submitted to X no later than the Monday following each payroll period, the 10th-of-the-month requirement for March would not be met.

A tip statement furnished after this deadline does not meet the requirements of section 6053(a). The employer is not required to withhold income, FICA, or RRTA taxes on tips reported after the 10th of the following month and is not responsible for reporting those tips to the IRS. The responsibility for reporting and paying the employee portion of the FICA tax shifts to the employee. The employee must complete and attach Form 4137, *Social Security and Medicare Tax on Unreported Tip Income*, to the employee's federal income tax return. Moreover, an employee who fails to report tips as required by section 6053(a) is subject to an addition to the FICA tax or the RRTA tax, whichever is applicable, equal to 50 percent of the employee portion of the FICA or RRTA tax on those tips.

Section 31.6053-4(a)(1) provides that an employee must maintain sufficient evidence to establish the amount of tip income received during a taxable year. Sufficient evidence consists of either a daily record or, if the employee does not maintain a daily record, other evidence (such as documentary evidence) that is as credible and as reliable as a daily record. Nevertheless, if the facts or circumstances indicate that the employee received a larger amount of tip income, a daily record or other evidence may not be sufficient evidence.

Section 31.6053-4(a)(2) describes the requirements for a daily record. In general, the daily record must show the amount of cash and charge tips received directly from customers or other employees and the amount of tips, if any, that the employee paid out to other employees through tip sharing, tip pooling, or other arrangements and the names of the employees. The daily record must show the date on which each entry is made. Each entry must be made on or near the date the tip income is received. An entry made when the employee has full present knowledge of those receipts and payments satisfies this requirement.

Section 31.6053-4(a)(3) describes documentary evidence. Documentary evidence consists of copies of any documents that contain amounts added as a tip

to a check by a customer or amounts paid by a customer for food or beverages with respect to which tips generally would be received. Examples of documentary evidence are copies of restaurant bills, credit card charges, or charges under any other arrangement containing amounts added by the customer as a tip.

Explanation of Provisions

Electronic tip statements. No provision currently exists for employees to furnish tip statements to employers in a form other than on paper. The proposed regulations would permit an employer to adopt a system under which some or all of the tipped employees of the employer would furnish their tip statements electronically. Therefore, the employer could include in its electronic system any tipped employee or employees working in any location or locations.

The proposed regulations set forth requirements for employers who wish to establish electronic systems for employees to use to furnish tip statements to their employers. The proposed regulations apply only to tip statements required by section 6053(a) and not with respect to any other Code sections.

An employer that chooses to establish an electronic tip reporting system may select the type or types of electronic systems (such as telephone or computer) to be used by its employees. The system must, however, ensure that the information received is the information transmitted by the employee and must document all occasions of access that result in the transmission of a tip statement. The design and operation of the electronic system, including access procedures, must make it reasonably certain that the person accessing the system and transmitting the tip statement is the employee identified in the transmission. In the event of an examination, the employer must supply a hard copy of the electronic statement to the IRS upon request.

The electronic tip statement must contain exactly the same information that is required to be reported on a paper tip statement and must contain the employee's electronic signature. The electronic signature must identify the employee furnishing the electronic tip statement and authenticate and verify the

transmission. An electronic signature can be in any form that satisfies the foregoing requirements. An electronic signature has the same effect as a signature written on a paper tip statement. See sections 6061, 6064, and 6065 of the Code.

Pursuant to Rev. Rul. 71-20 (1971-1 C.B. 392), all machine-sensible data media used for recording, consolidating, and summarizing accounting transactions and records within a taxpayer's ADP system are records within the meaning of section 6001 and §1.6001-1. The record retention requirements contained in Rev. Proc. 91-59 (1991-2 C.B. 841) (or any revenue procedure updating Rev. Proc. 91-59), dealing with automatic data processing systems, apply to electronic tip reporting systems.

The proposed regulations provide that an employee maintains sufficient evidence to establish the amount of tip income received by the employee during a calendar month through a daily record (as described in §31.6053-4(a)(2)) if the employee both reports tips on a daily basis through an electronic system that otherwise meets the substantiation requirements of the regulations and receives from the employer a hard copy of a daily record based on those entries for the period.

Employee substantiation requirements. Because the proposed regulations expand the permissible array of employer-designed reporting systems to include electronic methods, employers will be providing a statement to employees of the tips reported consistent with the existing requirements of §31.6053-1(b). The Treasury and the IRS recognize that many of these systems may capture tip reporting on a very current basis (e.g., point-of-sale or end-of-shift). Thus, the information in these systems offers a reasonable substitute for a daily record maintained by the employee if the employer's system provides the employee with a printout that would satisfy the current substantiation requirements of §31.6053-4.

Thus, these proposed regulations provide that, if the employer, at its option, provides employees with a copy of the daily record based on entries made by the employee in the system and otherwise satisfying the substantiation requirement of §31.6053-4, the entry in the electronic system on a daily (or more frequent) basis by the employee, together with the daily

record based on these entries provided by the employer, will satisfy the substantiation requirements of §31.6053-4. For example, assume an employee enters tips in the employer's electronic system at the end of each shift, but does not provide the employer with a signed paper record of these tips. After the end of each weekly payroll period, the employer provides the employee with a paper record that includes all the information specified in §31.6053-4(a)(2) and that shows the total amount of tips reported for each day during the period based on the employee's entries. If the employee maintains this employer generated paper record, the substantiation requirements of §31.6053-4 are satisfied.

The Treasury and the IRS particularly invite comment on whether the proposed regulations should be modified to reflect ways in which these systems may permit further reduction in paper reporting for either the employer or employee while retaining provisions for appropriate and timely substantiation of income.

Railroad Retirement Tax Act provisions. The tip reporting provisions of section 6053(a) apply to tips that are either wages for income tax withholding and Federal Insurance Contributions Act (FICA) purposes or compensation for Railroad Retirement Tax Act (RRTA) purposes. The proposed regulations would clarify that the regulations under section 6053(a) apply to tips that are compensation as well as to tips that are wages.

Proposed Effective Date

The revisions and additions in the proposed regulations apply to tips required to be reported to the employer after these regulations are published as final regulations in the **Federal Register**. However, taxpayers may rely on the guidance in these proposed regulations for prior periods.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations.

It is hereby certified that the collections of information in these regulations will not have a significant economic impact on a substantial number of small entities. The collection of information in §31.6053-1 is imposed solely on individuals, not on any small entities, and the regulations provide flexibility to employees who must provide the information required by statute, thereby reducing burden. With respect to the collection of information in §31.6053-4, the certification is based on the expectation of the IRS that most businesses that choose to implement the electronic tip reporting provisions will be larger businesses with many employees and sophisticated computer systems. Moreover, because the provision is wholly elective, any small business that would be adversely impacted may choose not to use electronic tip reporting. Finally, the Service expects that for those small entities that choose to implement the provision, the use of electronic tip reporting will reduce overall burden by reducing paper collections. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required.

Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight copies) that are submitted timely (in the manner described in the ADDRESSES portion of this preamble) to the IRS. All comments will be available for public inspection and copying.

A public hearing may be scheduled if requested in writing by any person that timely submits written comments. The IRS will also consider requests for remote teleconference sites as part of the public hearing. If a public hearing is scheduled, notice of the date, time, and place (including teleconference, if any) for the hearing will be published in the **Federal Register**.

Drafting Information

The principal author of these proposed regulations is Karin Loverud, Office of the Associate Chief Counsel (Employee Benefits and Exempt Organizations), IRS. However, other personnel from the IRS and the Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 31 is proposed to be amended as follows:

PART 31—EMPLOYMENT TAXES AND COLLECTION OF INCOME TAX AT SOURCE

Paragraph 1. The authority citation for part 31 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 31.6053-1 is amended as follows:

1. Paragraph (a) is revised.
2. The introductory text of paragraph (b)(1) is revised.
3. The last sentence of paragraph (b)(1)(iii) is revised.
4. Paragraph (b)(2) is revised.
5. Paragraph (c) is revised.
6. Paragraph (d) is added.

The revisions and additions read as follows:

§31.6053-1 Report of tips by employee to employer.

(a) *Requirement that tips be reported—(1) In general.* An employee who receives, in the course of employment by an employer, tips that constitute wages as defined in section 3121(a) or section 3401, or compensation as defined in section 3231(e), must furnish to the employer a statement, or statements, disclosing the total amount of the tips received by the employee in the course of employment by the employer. Tips received by an employee in a calendar month in the course of employment by an employer that are required to be reported to the employer must be reported on or before the 10th day of the following month. Thus, for example, tips received by an employee in January 1998 are required to be reported by the employee to

the employer on or before February 10, 1998.

(2) *Cross references.* For provisions relating to the treatment of tips as wages for purposes of the Federal Insurance Contributions Act (FICA) tax under sections 3101 and 3111, see sections 3102(c), 3121(a)(12), and 3121(q) and §§31.3102-3 and 31.3121(a)(12)-1. For provisions relating to the treatment of tips as wages for purposes of the tax under section 3402 (income tax withholding), see sections 3401(a)(16), 3401(f), and 3402(k) and §§31.3401(a)(16)-1, 31.3401(f)-1, and 31.3402(k)-1. For provisions relating to the treatment of tips as compensation for purposes of the Railroad Retirement Tax Act (RRTA) tax under sections 3201 and 3221, see section 3231(e) and §31.3231(e)-1(a).

(b) * * * (1) *In general.* The statement described in paragraph (a) of this section can be provided on paper or transmitted electronically. The statement must be signed by the employee and must disclose:

* * * * *

(iii) * * * If the statement is for a period of less than 1 calendar month, the beginning and ending dates of the period must be included (for example, January 1 through January 8, 1998).

* * * * *

(2) *Form of statement*—(i) *In general.* No particular form is prescribed for use in furnishing the statement required by this section. The statement may be furnished on paper or transmitted electronically. An electronic system and all tip statements generated by that system must meet the requirements of paragraph (d) of this section. If the employer does not provide any other means for the employee to report tips, the employee may use Form 4070, *Employee's Report of Tips to Employer*.

(ii) *Single-purpose forms.* A statement may be furnished on an employer-provided form. The form may be on paper or in electronic form. An employer that provides a paper form must make blank copies of the form readily available to all tipped employees. Any form, whether paper or electronic, provided by an employer for use by its tipped employees solely to report tips must meet all the re-

quirements of paragraph (b)(1) of this section.

(iii) *Regularly used forms.* Instead of requiring that tips be reported as described in paragraph (b)(2)(ii) of this section on a special form used solely for tip reporting, an employer may prescribe regularly used forms for use by employees in reporting tips. A regularly used form may be on paper (such as a time card or report) or in electronic form, must meet the requirements of paragraph (b)(1)(iii) and (iv) of this section, must contain identifying information that will ensure accurate identification of the employee by the employer, and is permitted to be used only if the employer furnishes the employee a statement suitable for retention showing the amount of tips reported by the employee for the period. The employer statement may be furnished when the employee reports the tips, when wages are first paid following the reporting of tips by the employee, or within a short time after the wages are paid. The employer may meet this requirement, for example, through the use of a payroll check stub or other payroll document regularly furnished by the employer to the employee showing gross pay and deductions. In the case of electronic tip reports, the employer statement may be furnished on a daily, weekly, monthly or on a regular payroll basis (if not less frequent than monthly).

(c) *Period covered by, and due date of, tip statement*—(1) *In general.* A tip statement furnished by an employee to an employer may not cover a period greater than 1 calendar month. An employer may, however, require the submission of a statement in respect of a specified period of time, for example, on a weekly or bi-weekly basis, regular payroll period, etc. An employer may specify, subject to the limitation in paragraph (a) of this section, the time within which, or the date on which, the statement for a specified period of time should be submitted by the employee. For example, a statement covering a payroll period may be required to be submitted on the first (or second) day following the close of the payroll period. A statement submitted by an employee after the date specified by the employer for its submission nevertheless will be considered as a statement furnished pursuant to section 6053(a) and this section if

it is submitted to the employer on or before the 10th day following the month in which the tips were received.

(2) *Termination of employment.* If an employee's employment is terminating, the employee must furnish a tip statement to the employer when the employee ceases to perform services for the employer. A statement submitted by an employee after the date on which the employee ceases to perform services for the employer will be considered as a statement furnished pursuant to section 6053(a) and this section if the statement is submitted to the employer on or before the earlier of the day on which the final wage payment is made by the employer to the employee or the 10th day following the month in which the tips were received.

(d) *Requirements for electronic systems*—(1) *In general.* The electronic system must ensure that the information received is the information transmitted by the employee and must document all occasions of access that result in the transmission of a tip statement. In addition, the design and operation of the electronic system, including access procedures, must make it reasonably certain that the person accessing the system and transmitting the statement is the employee identified in the statement transmitted.

(2) *Same information as on paper statement.* The electronic tip statement must provide the employer with all the information required by paragraph (b)(1) of this section.

(3) *Signature.* The electronic tip statement must be signed by the employee. The electronic signature must identify the employee transmitting the electronic tip statement and must authenticate and verify the transmission. For this purpose, the terms "authenticate" and "verify" have the same meanings as they do when applied to a written signature on a paper tip statement. An electronic signature can be in any form that satisfies the foregoing requirements.

(4) *Copies of electronic tip statements.* Upon request by the Internal Revenue Service (IRS), the employer must supply the IRS with a hard copy of the electronic tip statement and a statement that, to the best of the employer's knowledge, the electronic tip statement was filed by the named employee. The hard copy of the electronic tip statement must provide the

information required by paragraph (b)(1) of this section, but need not be a facsimile of Form 4070 or any employer-designed form.

(5) *Record retention.* The record retention requirements dealing with automatic data processing systems apply to electronic tip reporting systems.

Par. 3. Section 31.6053-4 is amended as follows:

1. A sentence is added to paragraph (a)(1) after the third sentence.

2. A sentence is added to paragraph (a)(2) after the fourth sentence.

The additions read as follows:

§31.6053-4 Substantiation requirements for tipped employees.

(a) * * *

(1) * * * The Commissioner may by revenue ruling, procedure or other guidance of general applicability provide for other methods of demonstrating evidence of tip income. * * *

(2) * * * In addition, an electronic system maintained by the employer that collects substantially similar information as Form 4070A may be used to maintain such daily record, provided the employee receives and maintains a paper copy of the daily record. * * *

* * * * *

Michael P. Dolan,
*Deputy Commissioner of
Internal Revenue.*

(Filed by the Office of the Federal Register on January 23, 1998, 8:45 a.m., and published in the issue of the Federal Register for January 26, 1998, 63 F.R. 3680)

Notice of Proposed Rulemaking

Abatement of Interest

REG-209276-87

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations relating to the abatement of interest attributable to unreasonable errors or delays by an officer or employee of the IRS in performing a

ministerial or managerial act. The proposed regulations reflect changes to the law made by the Tax Reform Act of 1986 and the Taxpayer Bill of Rights 2. The proposed regulations affect both taxpayers requesting abatement of certain interest and IRS personnel responsible for administering the abatement provisions.

DATES: Written comments and requests for a hearing must be received by April 8, 1998.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG-209276-87), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG-209276-87), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the INTERNET by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at http://www.irs.ustreas.gov/prod/tax_regs/comments.html.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, David Auclair, (202) 622-4910 (not a toll-free number). Concerning submissions, Michael Slaughter, (202) 622-7190 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed amendments to the Procedure and Administration Regulations (26 CFR Part 301) relating to the abatement of interest attributable to unreasonable errors or delays by an officer or employee of the IRS under section 6404(e)(1) of the Internal Revenue Code. Section 6404(e)(1) was enacted by section 1563(a) of the Tax Reform Act of 1986 (Public Law 99-514, 100 Stat. 2762 (1986)) (1986 Act) and amended by section 301 of the Taxpayer Bill of Rights 2 (Public Law 104-168, 110 Stat. 1452 (1996)) (TBOR2).

As enacted by the 1986 Act, section 6404(e)(1) provided that the IRS may abate interest attributable to any error or delay by an officer or employee of the

IRS (acting in an official capacity) in performing a ministerial act. The legislative history accompanying the Act provided,

The committee intends that the term 'ministerial act' be limited to nondiscretionary acts where all of the preliminary prerequisites, such as conferencing and review by supervisors, have taken place. Thus, a ministerial act is a procedural action, not a decision in a substantive area of tax law.

H.R. Rep. No. 426, 99th Cong., 1st Sess. 845 (1985); S. Rep. No. 313, 99th Cong., 2d Sess. 209 (1986).

Further, Congress did not intend that the abatement of interest provision "be used routinely to avoid payment of interest." H.R. Rep. No. 426, 99th Cong., 1st Sess. 844 (1985); S. Rep. No. 313, 99th Cong., 2d Sess. 208 (1986). Rather, Congress intended abatement of interest to be used in instances "where failure to abate interest would be widely perceived as grossly unfair." *Id.*

On August 13, 1987, the IRS published temporary regulations (T.D. 8150) in the **Federal Register** (52 F.R. 30162) relating to the definition of ministerial act for purposes of abatement of interest. A notice of proposed rulemaking (LR-34-87) cross-referencing the temporary regulations was also published in the Federal Register for the same day (52 F.R. 30177). No public hearing regarding these regulations was requested or held. In this document, the IRS is reproposing a modified version of the earlier notice of proposed rulemaking to incorporate changes made by TBOR2. Therefore, the earlier notice of proposed rulemaking is withdrawn.

The temporary regulations define ministerial act to mean a procedural or mechanical act that does not involve the exercise of judgment or discretion, and that occurs during the processing of a taxpayer's case after all prerequisites to the act, such as conferences and review by supervisors, have taken place. A decision concerning the proper application of federal tax law (or other federal or state law) is not a ministerial act. The temporary regulations also provide five examples to illustrate the definition of ministerial act.

In TBOR2, Congress amended section 6404(e)(1) to permit the IRS to abate interest attributable to any unreasonable error or delay by an officer or employee of the IRS (acting in an official capacity) in performing a managerial act as well as

a ministerial act. Thus, as a result of TBOR2, the IRS has the authority to abate interest in more situations than under prior law.

Pursuant to the legislative history accompanying TBOR2, a managerial act is a loss of records or a personnel management decision such as the decision to approve a personnel transfer, extended leave, or extended training. See H.R. Rep. No. 506, 104th Cong., 2d Sess. 27 (1996). TBOR2 distinguished a managerial act from a general administrative decision, such as a decision on how to organize the processing of tax returns or a decision regarding the implementation of an improved computer system. *Id.* A general administrative decision is a decision that impacts tax administration. The amendments to section 6404(e)(1) are effective for interest accruing with respect to deficiencies or payments for taxable years beginning after July 30, 1996.

TBOR2 also added section 6404(g). Section 6404(g) grants the Tax Court jurisdiction to determine whether the IRS's failure to abate interest for an eligible taxpayer is an abuse of discretion. Tax Court review is available for requests for abatement of interest that are made after July 30, 1996, or that have not been denied prior to July 31, 1996. See *Banat v. Commissioner*, 109 T.C. 92 (1997); *White v. Commissioner*, 109 T.C. 96 (1997).

Explanation of Provisions

TBOR2 expanded the scope of abatement relief under section 6404(e)(1). Consistent with congressional intent, the proposed regulations permit abatement of interest in more situations than under prior law. Nothing in the proposed regulations is intended to limit the extent to which the IRS could abate interest before the effective date of TBOR2.

The proposed regulations define managerial act and incorporate other changes made by TBOR2. TBOR2 did not alter the definition of ministerial act under prior law. Accordingly, the proposed regulations retain the definition of ministerial act in the temporary regulations.

Managerial act is defined as an administrative act that occurs during the processing of a taxpayer's case involving the temporary or permanent loss of records or the exercise of judgment or discretion re-

lating to management of personnel. A decision concerning the proper application of federal tax law (or other federal or state law) is not a managerial act. Further, interest attributable to a general administrative decision, such as the IRS's decision on how to organize the processing of tax returns or its delay in implementing an improved computer system, cannot be abated under section 6404(e)(1).

In addition, the proposed regulations provide examples to illustrate the definitions of ministerial act and managerial act. Examples 1, 2, 3, 7, and 8 of the proposed regulations are substantially similar to Examples 1 through 5 of the temporary regulations. However, in Example 3 of the proposed regulations (Example 4 of the temporary regulations), a decision to approve extended training is a managerial act, and in Example 8 of the proposed regulations (Example 5 of the temporary regulations) the type of work priority is specified.

The provisions of the regulations relating to a ministerial act apply to interest accruing with respect to deficiencies or payments of any tax described in section 6212(a) for taxable years beginning after December 31, 1978, for which the applicable statute of limitations has not expired. The provisions of the regulations relating to a managerial act are proposed to apply to interest accruing with respect to deficiencies or payments of any tax described in section 6212(a) for taxable years beginning after July 30, 1996.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. Chapter 5) does not apply to these regulations, and because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. Chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. All comments will be available for public inspection and copying. A public hearing may be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place of the hearing will be published in the **Federal Register**.

Drafting Information

The principal author of these regulations is David B. Auclair. However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 301 is proposed to be amended as follows:

PART 301—PROCEDURE AND ADMINISTRATION

Paragraph 1. The authority citation for part 301 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 301.6404-2 is added to read as follows:

§301.6404-2 Abatement of interest.

(a) *In general.* (1) Section 6404(e)(1) provides that the Commissioner may (in the Commissioner's discretion) abate the assessment of all or any part of interest on any—

(i) Deficiency (as defined in section 6211(a), relating to income, estate, gift, generation-skipping, and certain excise taxes) attributable in whole or in part to any unreasonable error or delay by an officer or employee of the Internal Revenue Service (IRS) (acting in an official capacity) in performing a ministerial or managerial act; or

(ii) Payment of any tax described in section 6212(a) (relating to income, estate, gift, generation-skipping, and certain

excise taxes) to the extent that any error or delay in payment is attributable to an officer or employee of the IRS (acting in an official capacity) being unreasonably erroneous or dilatory in performing a ministerial or managerial act.

(2) An error or delay in performing a ministerial or managerial act will be taken into account only if no significant aspect of the error or delay is attributable to the taxpayer involved or to a person related to the taxpayer within the meaning of section 267(b) or section 707(b)(1). Moreover, an error or delay in performing a ministerial or managerial act will be taken into account only if it occurs after the IRS has contacted the taxpayer in writing with respect to the deficiency or payment. For purposes of this paragraph (a)(2), no significant aspect of the error or delay is attributable to the taxpayer merely because the taxpayer consents to extend the period of limitations.

(b) *Definitions.* (1) *Managerial act* means an administrative act that occurs during the processing of a taxpayer's case involving the temporary or permanent loss of records or the exercise of judgment or discretion relating to management of personnel. A decision concerning the proper application of federal tax law (or other federal or state law) is not a managerial act. Further, interest attributable to a general administrative decision, such as the IRS's decision on how to organize the processing of tax returns or the IRS's decision on the implementation schedule for an improved computer system, cannot be abated under paragraph (a) of this section.

(2) *Ministerial act* means a procedural or mechanical act that does not involve the exercise of judgment or discretion, and that occurs during the processing of a taxpayer's case after all prerequisites to the act, such as conferences and review by supervisors, have taken place. A decision concerning the proper application of federal tax law (or other federal or state law) is not a ministerial act.

(c) *Examples.* The following examples illustrate the provisions of paragraphs (b)(1) and (b)(2) of this section. For the purposes of the examples, no significant aspect of any error or delay is attributable to the taxpayer, and the IRS has contacted the taxpayer in writing with respect to the deficiency.

Example 1. A taxpayer moves from one state to another before the IRS selects the taxpayer's income tax return for examination. A letter explaining that the return has been selected for examination is sent to the taxpayer's old address and then forwarded to the new address. The taxpayer timely responds, asking that the audit be transferred to the IRS's district office that is nearest the new address. The group manager approves the request. After the request for transfer has been approved, the transfer of the case is a ministerial act. The Commissioner may (in the Commissioner's discretion) abate interest attributable to any unreasonable delay in transferring the case.

Example 2. An examination of a taxpayer's income tax return reveals a deficiency with respect to which a notice of deficiency will be issued. The taxpayer and the IRS identify all agreed and unagreed issues, the notice is prepared and reviewed (including review by District Counsel, if necessary) and any other relevant prerequisites are completed. The issuance of the notice of deficiency is a ministerial act. The Commissioner may (in the Commissioner's discretion) abate interest attributable to any unreasonable delay in issuing the notice.

Example 3. A revenue agent is sent to a training course for an extended period of time, and the agent's supervisor decides not to reassign the agent's cases. During the training course, no work is done on the cases assigned to the agent. The decision to send the revenue agent to the training course and the decision not to reassign the agent's cases are not ministerial acts; however, both decisions are managerial acts. The Commissioner may (in the Commissioner's discretion) abate interest attributable to any unreasonable delay resulting from these decisions.

Example 4. A taxpayer appears for an office audit and submits all necessary documentation and information. The auditor tells the taxpayer that the taxpayer will receive a copy of the audit report. However, before the report is prepared, the auditor is permanently reassigned to another group. An extended period of time passes before the auditor's cases are reassigned. The decision to reassign the auditor and the decision not to reassign the auditor's cases are not ministerial acts; however, they are managerial acts. The Commissioner may (in the Commissioner's discretion) abate interest attributable to any unreasonable delay resulting from these decisions.

Example 5. A taxpayer is notified that the IRS intends to audit the taxpayer's income tax return. The agent assigned to the case is granted sick leave for an extended period of time and the taxpayer's case is not reassigned. The decision to grant sick leave and the decision not to reassign the taxpayer's case to another agent are not ministerial acts; however, they are managerial acts. The Commissioner may (in the Commissioner's discretion) abate interest attributable to any unreasonable delay caused by these decisions.

Example 6. A revenue agent has completed an examination of the income tax return of a taxpayer. There are issues that are not agreed upon between the taxpayer and the IRS. Before the notice of deficiency is prepared and reviewed, a clerical employee misplaces the taxpayer's case file. The act of misplacing the case file is a managerial act. The Commissioner may (in the Commissioner's discretion)

abate interest attributable to any unreasonable delay resulting from the file being misplaced.

Example 7. A taxpayer invests in a tax shelter and reports a loss from the tax shelter on the taxpayer's income tax return. IRS personnel conduct an extensive examination of the tax shelter, and the processing of the taxpayer's case is delayed because of that examination. The decision to delay the processing of the taxpayer's case until the completion of the examination of the tax shelter is a decision on how to organize the processing of tax returns. This is a general administrative decision. Consequently, interest attributable to this decision cannot be abated under paragraph (a) of this section.

Example 8. A taxpayer claims a loss on the taxpayer's income tax return and is notified that the IRS intends to examine the return. However, a decision is made not to commence the examination of the taxpayer's return until the processing of another return, for which the statute of limitations is about to expire, is completed. The decision on how to prioritize the processing of returns based on the expiration of the statute of limitations is a general administrative decision. Consequently, interest attributable to this decision cannot be abated under paragraph (a) of this section.

Example 9. During the examination of an income tax return, there is disagreement between the taxpayer and the revenue agent regarding certain itemized deductions claimed by the taxpayer on the return. To resolve the issue, Examination requests advice from the Office of Chief Counsel on a substantive issue of federal tax law. The decision to request advice is a decision concerning the proper application of federal tax law; it is neither a ministerial nor a managerial act. Consequently, interest attributable to a delay resulting from the decision to request advice cannot be abated under paragraph (a) of this section.

Example 10. The facts are the same as in Example 9 except the attorney who is assigned to respond to the request for advice is granted leave for an extended period of time. The case is not reassigned during the attorney's absence. The decision to grant leave and the decision not to reassign the taxpayer's case to another attorney are not ministerial acts; however, they are managerial acts. The Commissioner may (in the Commissioner's discretion) abate interest attributable to any unreasonable delay caused by these decisions.

Example 11. A taxpayer contacts an IRS employee and requests the amount due to satisfy the taxpayer's income tax liability for a particular taxable year. Because the employee fails to access the most recent data, the employee gives the taxpayer an incorrect amount due. As a result, the taxpayer pays less than the amount required to satisfy the tax liability. Accessing the most recent data is a ministerial act. The Commissioner may (in the Commissioner's discretion) abate interest attributable to any unreasonable error or delay arising from giving the taxpayer an incorrect amount due to satisfy the taxpayer's income tax liability.

Example 12. A taxpayer contacts an IRS employee and requests the amount due to satisfy the taxpayer's income tax liability for a particular taxable year. To determine the current amount due, the employee must interpret complex provisions of federal tax law involving net operating loss carrybacks and foreign tax credits. Because the employee incor-

rectly interprets these provisions, the employee gives the taxpayer an incorrect amount due. As a result, the taxpayer pays less than the amount required to satisfy the tax liability. Interpreting federal tax law is neither a ministerial nor a managerial act. Consequently, interest attributable to an error or delay arising from giving the taxpayer an incorrect amount due to satisfy the taxpayer's income tax liability cannot be abated under paragraph (a) of this section.

(d) *Effective date.* The provisions of this section apply to interest accruing with respect to deficiencies or payments of any tax described in section 6212(a) for taxable years beginning after July 30, 1996.

Michael P. Dolan,
*Deputy Commissioner of
Internal Revenue.*

(Filed by the Office of the Federal Register on January 7, 1998, 8:45 a.m., and published in the issue of the Federal Register for January 8, 1998, 63 F.R. 1086)

Notice of Proposed Rulemaking

Continuation Coverage Requirements of Group Health Plans

REG-209485-86

AGENCY: Internal Revenue Service
(IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations that provide guidance under section 4980B of the Internal Revenue Code on certain changes made by the Health Insurance Portability and Accountability Act of 1996, the Omnibus Budget Reconciliation Act of 1989, and the Technical and Miscellaneous Revenue Act of 1988 relating to the continuation coverage requirements applicable to group health plans. The regulations will generally affect sponsors of and participants in group health plans, and they provide plan sponsors and plan administrators with guidance necessary to comply with the law.

DATES: Written comments and requests for a public hearing must be received by April 7, 1998.

ADDRESSES: Send Submissions to:
CC:DOM:CORP:R (REG-209485-86),

room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG-209485-86), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at http://www.irs.ustreas.gov/prod/tax_regs/comments.html.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Russ Weinheimer, 202-622-4695; concerning submissions or requests for a hearing, LaNita VanDyke, 202-622-7190 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in this notice of proposed rulemaking has been submitted to the Office of Management and Budget (OMB) for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information should be sent to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, T:FP, Washington, DC 20224. Comments on the collection of information should be received by March 9, 1998. Comments are specifically requested concerning the following:

Whether the proposed collection of information is necessary for the proper performance of the functions of the Internal Revenue Service, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information;

How to enhance the quality, utility, and clarity of the information to be collected;

How to minimize the burden of complying with the proposed collection of information, including the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to provide information.

The collection of information is in proposed §54.4980B-1(a)(1)(iii). This collection of information is required by statute. The likely respondents are individuals. Responses to this collection of information are required in order to obtain the benefit of an extended period during which a group health plan must make COBRA continuation coverage available.

Estimated total annual reporting burden: 440 hours.

The estimated annual burden per respondent: 1 minute.

Estimated number of respondents: 26,400.

Estimated annual frequency of responses: on occasion.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

The Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA) amended the Code to add health care continuation coverage requirements. These provisions, now set forth in section 4980B of the Code,¹ generally apply to a group health plan maintained by an employer with at least 20 employees, and require such a plan to offer each qualified beneficiary who would otherwise lose coverage as a result of a qualifying event an opportunity to elect, within the applicable election period, COBRA continua-

¹The COBRA continuation coverage requirements were initially set forth under section 162(k) of the Code, but were moved to section 4980B of the Code by the Technical and Miscellaneous Revenue Act of 1988 (TAMRA). TAMRA changed the sanction for failure to comply with the continuation coverage requirements of the Code from a disallowance of certain employer deductions under section 162 (and denial of the income exclusion under section 106(a) to certain highly compensated employees of the employer) to an excise tax under section 4980B.

tion coverage. The COBRA continuation coverage requirements were amended on various occasions,² most recently under the Health Insurance Portability and Accountability Act of 1996 (HIPAA).

Proposed regulations providing guidance under the continuation coverage requirements as originally enacted by COBRA and as amended by the Tax Reform Act of 1986, were published as proposed Treasury Regulation §1.162-26 in the Federal Register of June 15, 1987 (52 F.R. 22716).

The new set of proposed regulations being published in this notice of proposed rulemaking reflects principally the most recent set of statutory changes — those made by HIPAA — but also reflects certain changes made by the Technical and Miscellaneous Revenue Act of 1988 (TAMRA) and by the Omnibus Budget Reconciliation Act of 1989 (OBRA '89).

Explanation of Provisions

Disability Extension; Permitted Premiums.

As originally enacted, the COBRA continuation coverage provisions required plans to make continuation coverage available for up to 18 months in the case of a qualifying event that is a termination of employment or reduction in hours of employment and for up to 36 months for all other qualifying events, such as death of the covered employee, divorce from the covered employee, or a dependent child ceasing to be a dependent under the generally applicable requirements of the plan. If someone became entitled to the 18-month maximum period of coverage and experienced a second qualifying event during that period of COBRA continuation coverage, then the law provided an extended period of coverage so that

there would be a total of 36 months of COBRA continuation coverage measured from the date of the first qualifying event.

Under OBRA '89, provisions were added allowing the 18-month period to be extended to 29 months if a qualified beneficiary was disabled at the time of the qualifying event. Section 421 of HIPAA changed these provisions by requiring plans to allow the disability extension if a qualified beneficiary is disabled within the first 60 days of COBRA continuation coverage and by clarifying that nondisabled qualified beneficiaries with respect to the same qualifying event are also entitled to the disability extension.

Thus, under the current provisions in the Code, all qualified beneficiaries with respect to the same qualifying event are entitled to an extension of the maximum period of COBRA continuation coverage from 18 to 29 months, if three conditions are satisfied. First, each qualified beneficiary must be a qualified beneficiary in connection with a qualifying event that is a termination of employment or reduction in hours of employment. Second, a qualified beneficiary must be determined to have been disabled (within the meaning of title II or title XVI of the Social Security Act) within the first 60 days of COBRA continuation coverage. Third, the plan administrator must be provided with a copy of the determination of disability on a date that is both within 60 days after the determination is issued and before the end of the initial 18-month period of COBRA continuation coverage. In the case of a disability extension, for any period after the end of the 18th month of COBRA continuation coverage, the plan may generally require payment for COBRA continuation coverage in an amount that does not exceed 150 percent of the applicable premium.

These proposed regulations clarify the statutory disability extension requirements in several respects. For example, the first 60 days of COBRA continuation coverage are generally measured from the date of the termination of employment or reduction in hours of employment. An exception applies if coverage would be lost (in the absence of an election for COBRA continuation coverage) after the date of the qualifying event and if the plan has elected to measure both the maximum coverage period and the period for pro-

viding notice upon the occurrence of a qualifying event from the date that coverage would be lost rather than from the date of the qualifying event. In such a case, the first 60 days of COBRA continuation coverage are also measured from the date that coverage would be lost.

In addition, these proposed regulations make clear that the disability extension applies to each qualified beneficiary, whether or not disabled, that each qualified beneficiary has an independent right to the disability extension, and that any of the qualified beneficiaries may provide the plan administrator with a copy of the determination of disability.

Another clarification relates to the period during which the plan may charge 150 percent of the applicable premium. These proposed regulations make clear that the plan may require payment equal to 150 percent of the applicable premium if a disabled qualified beneficiary experiences a second qualifying event during the disability extension. In such a case (that is, where the disabled qualified beneficiary is entitled to a 36-month maximum coverage period only because a second qualifying event occurs during the disability extension), the plan may require payment of 150 percent of the applicable premium until the end of the 36-month maximum coverage period.

HIPAA also added provisions to the Code, in section 9802(b), that generally prohibit discrimination in premiums on the basis of health status, including on the basis of disability. These proposed regulations clarify that a plan that requires a disabled qualified beneficiary entitled to the disability extension to pay 150 percent of the applicable premium (as permitted by the proposed regulations) does not for that reason fail to comply with the nondiscrimination requirements of section 9802(b).

These proposed regulations do not address the extent to which a plan can charge 150 percent of the applicable premium to a qualified beneficiary who is not disabled. Comments are requested on this issue.

Newborn and Adopted Children Treated as Qualified Beneficiaries.

Section 421 of HIPAA also provides that a child born to or placed for adoption

²Changes affecting the COBRA continuation coverage provisions were made under the Omnibus Budget Reconciliation Act of 1986, the Tax Reform Act of 1986, the Technical and Miscellaneous Revenue Act of 1988, the Omnibus Budget Reconciliation Act of 1989, the Omnibus Budget Reconciliation Act of 1990, the Small Business Job Protection Act of 1996, and the Health Insurance Portability and Accountability Act of 1996. The statutory continuation coverage requirements have also been affected by an amendment made to the definition of group health plan in section 5000(b)(1) by the Omnibus Budget Reconciliation Act of 1993; that definition is incorporated by reference in section 4980B(g)(2).

with the covered employee during a period of COBRA continuation coverage is a qualified beneficiary. Such a child generally is eligible to be enrolled immediately for COBRA continuation coverage under the plan. These proposed regulations clarify that the maximum coverage period for such a child is measured from the date of the qualifying event that gives rise to the period of COBRA continuation coverage during which the child is born or adopted and not from the date of birth or placement for adoption. Thus, the child's maximum period of COBRA continuation coverage would end at the same time as the maximum period for other family members. In addition, the statutory term *placement for adoption* is clarified to include an adoption that is not preceded by a placement for adoption.

Long-term Care; MSAs.

Section 321(d) of HIPAA amended section 4980B of the Code to provide that a plan does not constitute a group health plan subject to the COBRA continuation coverage requirements if substantially all of the coverage provided under the plan is for qualified long-term care services, as defined in section 7702B(c). These proposed regulations permit a plan to use any reasonable method in determining whether substantially all of the coverage is for qualified long-term care services. Further, the proposed regulations reflect section 106(b)(5), added by HIPAA, which provides that COBRA continuation coverage is not required to be made available with respect to medical savings accounts (MSAs), as defined under section 220.

Good Faith/Reasonable Interpretations.

The effective date of these regulations, when made final, will not be earlier than the date of publication of final regulations in the **Federal Register**. For the period before the effective date of final regulations, plans and employers are required to operate in good faith compliance with a reasonable interpretation of the statutory requirements. Compliance with the terms of the proposed regulations concerning the matters addressed is deemed to be good faith compliance with a reasonable interpretation of the statutory requirements. Actions inconsistent with the terms of the proposed regulations will not necessarily constitute a lack of good faith

compliance with a reasonable interpretation of the statutory requirements; whether there has been good faith compliance with a reasonable interpretation of the statutory requirements will depend on all the facts and circumstances of each case. Plans and employers may also continue to rely on proposed Treasury Regulation §1.162-26 (published on June 15, 1987 in 52 F.R. 22716), except to the extent that that proposed regulation is inconsistent with statutory amendments made after its date of publication.

Future Guidance Concerning COBRA Obligations in Certain Stock and Asset Sales.

Treasury and the IRS are currently considering the issuance of guidance concerning COBRA obligations in cases involving a sale of stock in an employer that causes the employer to become a member of another controlled group of corporations (a "stock sale"), or a sale of substantial assets by an employer (such as a plant or division) to another employer outside the controlled group (an "asset sale").

The approach under consideration generally would provide, in the case of a stock sale to a buyer maintaining a group health plan, that the buyer's group health plan (and not a plan maintained by the seller) would be responsible, after the date of the sale, for complying with the COBRA continuation coverage requirements with respect to any covered employee (and associated qualified beneficiary) whose last employment was with the sold corporation. Thus, for example, the buyer's group health plan would have the obligation, after the date of the sale, to comply with the COBRA continuation coverage requirements with respect to those individuals regardless of whether their qualifying events were connected to the sale of stock or were in advance of and not connected to the sale. If the buyer did not maintain a group health plan, then a group health plan of the seller would continue to be responsible for complying with the COBRA continuation coverage requirements with respect to qualified beneficiaries associated with the sold corporation.

In the case of an asset sale, the approach under consideration generally would provide that a group health plan maintained by the seller (and not a plan

maintained by the buyer) would be responsible for complying with the COBRA continuation coverage requirements with respect to any covered employee (and associated qualified beneficiary) whose last employment was associated with the purchased assets. However, an exception would be provided if the buyer were a "successor employer," in which case a group health plan of the buyer would be responsible for complying with the COBRA continuation coverage requirements with respect to qualified beneficiaries associated with the purchased assets. Consideration is being given to treating a buyer as a successor employer in connection with an asset sale only if the buyer acquires substantial assets (such as a plant or division, or substantially all of the assets of a trade or business) and continues the business operations associated with those assets without interruption or substantial change, and only if, in connection with the sale, the selling employer ceases to maintain any group health plan. The approach might also include a presumption that the cessation is in connection with the sale if it occurs within 6 months of the sale.

Comments are requested on this possible approach to assigning responsibility for compliance with the COBRA continuation coverage requirements in the context of stock sales and asset sales and on any related issues that should be addressed.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It is hereby certified that the collection-of-information requirement in these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that the collection-of-information requirement is imposed on individual qualified beneficiaries and not on small businesses or other small entities. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for

Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments that are submitted timely (a signed original and eight (8) copies) to the IRS. All comments will be available for public inspection and copying. A public hearing may be scheduled if requested in writing by a person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the hearing will be published in the **Federal Register**.

Drafting Information

The principal author of these proposed regulations is Russ Weinheimer, Office of the Associate Chief Counsel (Employee Benefits and Exempt Organizations). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR Part 54 is proposed to be amended as follows:

Paragraph 1. The authority citation for Part 54 is amended in part by adding an entry in numerical order to read as follows:

Authority: 26 U.S.C. 7805 * * *

Section 54.4980B-1 also issued under 26 U.S.C. 4980B. * * *

Par. 2. A new section 54.4980B-1 is added to read as follows:

§ 54.4980B-1 Certain changes to the continuation coverage requirements of group health plans.

(a) *Disability extension*—(1) *In general.* Paragraphs (a)(2), (3), and (4) of this section (describing qualified beneficiaries entitled to a disability extension, the length of the extension, and the amount that a plan can require qualified beneficiaries to pay during the extension) apply to a group health plan only if all three of the conditions of this paragraph (a)(1) are satisfied.

(i) A termination-of-employment qualifying event occurs.

(ii) An individual (whether or not the covered employee) who is a qualified beneficiary in connection with the termination-of-employment qualifying event is determined under title II or XVI of the Social Security Act to have been disabled at any time during the first 60 days of COBRA continuation coverage. For this purpose, the first 60 days of COBRA continuation coverage are measured from the date of the termination-of-employment qualifying event, except that if a loss of coverage would occur at a later date in the absence of an election for COBRA continuation coverage and if the plan provides for the extension of required periods (as permitted under section 4980B(f)(8)), then the first 60 days of COBRA continuation coverage are measured from the date on which the coverage would be lost.

(iii) Any of the qualified beneficiaries affected by the termination-of-employment qualifying event provides notice to the plan administrator of the disability determination on a date that is both within 60 days after the date the determination is issued and before the end of the original 18-month maximum coverage period that applies to the termination-of-employment qualifying event.

(2) *Maximum coverage period*—(i) The maximum coverage period ends—

(A) 29 months after the date of the termination-of-employment qualifying event; or

(B) 36 months after the date of the termination-of-employment qualifying event if a qualifying event (other than a bankruptcy qualifying event) occurs during the 29-month period that begins on the date of the termination-of-employment qualifying event.

(ii) If, in the absence of an election for COBRA continuation coverage, coverage under the group health plan would be lost after the date of the termination-of-employment qualifying event and the plan provides for the extension of the required periods, as permitted under section 4980B(f)(8), then the dates or periods in paragraph (a)(2)(i) of this section are measured from the date on which coverage would be lost and not from the date of the termination-of-employment qualifying event.

(iii) Nothing in section 4980B or this section prohibits a group health plan from providing coverage that continues beyond the end of the maximum coverage period.

(3) *Application to all qualified beneficiaries.* Paragraph (a)(2) of this section applies to all qualified beneficiaries entitled to COBRA continuation coverage because of the same termination-of-employment qualifying event. Thus, for example, the 29-month period applies to each qualified beneficiary who is not disabled as well as to the qualified beneficiary who is disabled, and it applies independently with respect to each of the qualified beneficiaries.

(4) *Payment during disability extension*—(i) *Disabled qualified beneficiaries*—(A) A group health plan is permitted to require a disabled qualified beneficiary described in paragraph (a)(1) of this section, for any period of COBRA continuation coverage after the end of the 18th month, to pay an amount that does not exceed 150 percent of the applicable premium. However, the plan is not permitted to require a disabled qualified beneficiary described in paragraph (a)(1) of this section to pay an amount that exceeds 102 percent of the applicable premium for any period of COBRA continuation coverage to which the qualified beneficiary is entitled without regard to the application of this paragraph (a). Thus, if a disabled qualified beneficiary described in paragraph (a)(1) of this section experiences a second qualifying event within the original 18-month period of COBRA continuation coverage, then the plan is not permitted to require the qualified beneficiary to pay an amount that exceeds 102 percent of the applicable premium for any period of COBRA continuation coverage. By contrast, if a disabled qualified beneficiary described in paragraph (a)(1) of this section experiences a second qualifying event after the end of the 18th month of original COBRA continuation coverage, the plan may require the qualified beneficiary to pay an amount that is up to 150 percent of the applicable premium for the remainder of the period of COBRA continuation coverage (that is, from the beginning of the 19th month through the end of the 36th month).

(B) A group health plan does not fail to comply with section 9802(b) and §54.9802-1T(b) (which generally pro-

hibit an individual from being charged, on the basis of health status, a higher premium than that charged for similarly situated individuals enrolled in the plan) with respect to a disabled qualified beneficiary described in paragraph (a)(1) of this section merely because the plan requires payment of a premium in an amount permitted under paragraph (a)(4)(i)(A) of this section.

(ii) *Nondisabled qualified beneficiaries.* [Reserved].

(b) *Newborns and adopted children.* A child who is born to or placed for adoption with a covered employee during a period of COBRA continuation coverage is a qualified beneficiary and generally is eligible to be enrolled immediately for COBRA continuation coverage under the plan. See section 4980B(g)(1)(A), section 9801(f)(2) and §54.9801-6T(b) (relating to special enrollment rights of dependents of employees), and Q&A-31 of §1.162-26 of this chapter (relating to the right of qualified beneficiaries to have new family members covered to the same extent that similarly situated active employees can have new family members covered under the plan). Such a child has the same open-enrollment-period rights as other qualified beneficiaries with respect to the same qualifying event (see Q&A-30(c) of §1.162-26 of this chapter) and would be entitled to a 36-month maximum coverage period if a second qualifying event occurred while the child was in a period of COBRA continuation coverage resulting from a termination-of-employment qualifying event. The maximum coverage period for such a child is measured from the same date as for other qualified beneficiaries with respect to the same qualifying event (and not from the date of the birth or placement for adoption). In contrast, neither the covered employee, the spouse of the covered employee, nor any other dependent child of the covered employee is a qualified beneficiary unless that person is covered under a group health plan on the day before a qualifying event. See also Q&A-31 of §1.162-26 of this chapter.

(c) *Plan providing long-term care.* A plan is not subject to the COBRA continuation coverage requirements if substantially all of the coverage provided under the plan is for qualified long-term care services (as defined in section 7702B(c)).

For this purpose, a plan is permitted to use any reasonable method in determining whether substantially all of the coverage under the plan is for qualified long-term care services.

(d) *Medical savings accounts.* Under section 106(b)(5), amounts contributed by an employer to a medical savings account are not considered part of a group health plan that is subject to section 4980B. Thus, a plan is not required to make COBRA continuation coverage available with respect to a medical savings account. However, a high deductible health plan that covers a medical savings account holder may be a group health plan and thus may be subject to the COBRA continuation coverage requirements.

(e) *Definitions.* For purposes of this section —

Applicable premium is defined in section 4980B(f)(4).

Bankruptcy qualifying event is a qualifying event described in section 4980B(f)(3)(F) (relating to certain bankruptcy proceedings).

Covered employee is defined in section 4980B(f)(7).

Group health plan is defined in section 4980B(g)(2).

High deductible health plan is defined in section 220(c)(2).

Medical savings account is defined in section 220(d).

Placement, or being placed, for adoption means the assumption and retention by the covered employee of a legal obligation for total or partial support of a child in anticipation of the adoption of the child. The child's placement for adoption with the covered employee terminates upon the termination of the legal obligation for total or partial support. For purposes of this section and section 4980B, a child who is immediately adopted by the covered employee without a preceding placement for adoption is considered to be placed for adoption on the date of the adoption.

Qualified beneficiary is defined in section 4980B(g)(1).

Qualified long-term care services is defined in section 7702B(c).

Termination-of-employment qualifying event is a qualifying event described in section 4980B(f)(3)(B) (relating to qualifying events that occur as a result of a termination of employment, other than for

gross misconduct, or reduction of hours of employment).

Michael P. Dolan,
Deputy Commissioner of
Internal Revenue.

(Filed by the Office of the Federal Register on January 6, 1998, 8:45 a.m., and published in the issue of the Federal Register for January 7, 1998, 63 F.R. 708)

Change in Record Format For TY 1998 Returns To Be Filed in CY 1999

Announcement 98-20

The purpose of this announcement is to inform all payers/transmitters, who file information returns magnetically or electronically with Internal Revenue Service (IRS) Martinsburg Computing Center, of a change in the record format for **tax year 1998** returns to be filed in **calendar year 1999**. Due to the century date change, legislative changes, and proposed future expansion, the record size will be increased from the current 420 positions to 750 positions. This will enable IRS to capture all data required to be filed. Several examples of changes are: the number of money fields have been expanded from 9 to 12, and blank fields have been added to enable IRS to capture more complete name and address information in the future. Although the record has changed, much of the information is data already requested in the present format.

Publication 1220, Specifications for Filing Forms 1098, 1099 series, 5498, 5498-MSA and W-2G Magnetically or Electronically, is being revised and is scheduled to be available on the Information Reporting Program Bulletin Board System (IRP-BBS) by May 1998 in an effort to give payers/transmitters as much time as possible to incorporate the changes into their programs. The telephone number for the IRP-BBS is 304-264-7070. IRS is planning additional Information Reporting Seminars to assist filers with the new format.

Due to the fact we are unable to discuss any other changes in detail until the publication has gone through all necessary clearances, no further information will be provided at this time.

Foundations Status of Certain Organizations

Announcement 98-21

The following organizations have failed to establish or have been unable to maintain their status as public charities or as operating foundations. Accordingly, grantors and contributors may not, after this date, rely on previous rulings or designations in the Cumulative List of Organizations (Publication 78), or on the presumption arising from the filing of notices under section 508(b) of the Code. This listing does *not* indicate that the organizations have lost their status as organizations described in section 501(c)(3), eligible to receive deductible contributions.

Former Public Charities. The following organizations (which have been treated as organizations that are not private foundations described in section 509(a) of the Code) are now classified as private foundations:

Child Care Resources Inc., Maidens, VA
 Children Medical Foundation, Clearwater, FL
 Childhood Hope Inc., Sevierville, TN
 Childlife International, Hopkins, MN
 Childreach Pursuing Parenthood Inc., Norton, OH
 Clearwater Aquatic Team Booster Club, Inc., Clearwater, FL
 Clergy Housing Support Group Inc., Philadelphia, PA
 Cleveland Community Access Corporation, Cleveland, OH
 Cleveland Student Housing Association, Independence, OH
 Cleveland Theatre Company, Cleveland, OH
 Community Actors of St. Bernard Theatre—C.A.S.T., Chalmette, LA
 Community Advocacy of South Texas Inc., Pharr, TX
 Community Alliance of Pinellas for Aids, Inc., St. Petersburg, FL
 Community and Educational Services for Family Youth and Senior Development Corporation, Detroit, MI
 Community Care and Share Pantry, West Salem, WI
 Community Care Co., Sapulpa, OK
 Community Consulting & Research Group Incorporated, Easton, MD
 Community Corrections Advisory Board, Jamestown, ND
 Community Economic and Ecological Development Institute, Santa Fe, NM

Community Gathering Place Association, Columbus, OH
 Crown of the Continent Conservancy, Kalispell, MT
 Crusaders Community Development, Philadelphia, PA
 Crystal Beach Volunteer Fire Dept., Crystal Beach, TX
 CSC Charities Inc., Chicago, IL
 Cuban National Congress Inc., Hialeah, FL
 Cullman Alzheimers and Related Disorders Support Group, Cullman, AL
 Culpeper Senior Center Inc., Culpeper, VA
 Cultural Center for Social Change, Washington, DC
 Cultural Treasures of New Orleans, New Orleans, LA
 Cushing Regional Hospital, Cushing, OK
 Custer County Family Preservation, Broken Bow, NE
 Cuyahoga County Local Council on Physical Fitness and Sports, Cleveland, OH
 Derry Township Bridge Housing Association, Hershey, PA
 Desarrolladora Nuestro Barrio Inc., Rio Piedras, PR
 Desert Storm Coalition Veterans Memorial Fund, Washington, DC
 Design Your Life Inc., Palm Beach Gardens, FL
 Dodge City Academic Booster Club, Dodge City, KS
 Doingsomething of Baltimore Inc., Baltimore, MD
 Dolf Seeds Ministries Inc., Odenville, AL
 Dolphin Assisted Therapy Association Inc., Miami, FL
 Domestic Violence Intervention Services Guild Inc., Tulsa, OK
 Donald O. Oldmixon Memorial Public Service Scholarship Trust Fund, Goliad, TX
 Dooly County Arts Council Inc., Vienna, GA
 Door to Recovery Inc., Houston, TX
 Educational Fund for the Blind, Shoshoni, WY
 Educational Grants and Loans Association, Colorado Springs, CO
 Educational Imperatives, Boulder, CO
 Educational Opportunities International, Houghton, MI
 Educational Resource Development Corporation, Shawnee Mission, KS
 Erie Area Local Education Fund, Erie, PA

Erie Maritime Programs Inc., Erie, PA
 Ethics Institute, Washington, DC
 Ethiopian Community Media Service, Washington, DC
 Evangel Christian Ministries Inc., Wilmore, KY
 Evangeline Human Development Inc., Villa Platte, LA
 Evanston Lighthouse Rotary Club, Evanston, IL
 Evergreen Behavioral Health Center, New Martinsville, WV
 Everlastings Inc., Warrenton, VA
 Exodo Foundation, Houston, TX
 Extended Arms Outreach Center Inc., Pensacola, FL
 Extra Mile JPHSA Inc., Metairie, LA
 Eyes on the Sparrow Ministry Inc., Baltimore, MD
 F A C E of Fond Du Lac County Inc., Fond Du Lac, WI
 F O U R International, Detroit, MI
 Face of the City Inc., Goshen, IN
 Felons and Community Together, Waterloo, IA
 Fencing Advisory Associates Inc., Mishawaka, IN
 Ferrier Harris Residential Care Inc., St. Louis, MO
 Foster and Maralee Overcash Scholarship Trust, Canton, IL
 Foundation for Parents, Austin, TX
 Foundation for the Advancement of Professional Psychology Education, Wheeling, IL
 Friends of Pre-Release, Athens, AL
 Friends of Rutgers University Equine Research Inc., Montclair, NJ
 Friends of Tagore Inc., Atlantis, FL
 Friends of the Newport News Juvenile Court, Newport News, VA
 Friends of the Pere Marquette Trail, Midland MI
 Friends of the Quilt-National Capital Area, Washington, DC
 Grand Canyon Pioneers Society, Grand Canyon, AZ
 Grand Junction Baseball Committee Inc., Grand Junction, CO
 Grand Rapids Area Choral Ensemble, Grand Rapids, MI
 Grand River and Nature Discovery Project, Clarklake, MI
 Grand Valley Public Radio Company, Grand Junction, CO
 Grandma Dottie Senior Charities, Littleton, CO
 Grandmas House Christian Childcare and

Preschool Inc., Isle of Wight County,
VA
Grant-a-Wish Incorporated, Albuquerque,
NM
Gratiot County Widowed Persons
Service, Alma, MI
Grayling Ausable Football League,
Grayling, MI
Hawkeye Community Historical Center,
West Union, IA
Hays Lewis Sporting Clays Foundation
Inc., Pavo, GA
Hayward Elementary & Middle School
Playground Committee Fund,
Hayward, WI
He Shall Supply Ministries Inc., Vero
Beach, FL
Headspeth Inc., Atlanta, GA
Hearts to Hearts Inc., Miami, FL
Healthsearch Inc., Anderson, IN

Hebron Arabians Inc., Clovis, NM
Hegewisch Sports Facility Coalition Inc.,
Chicago, IL
Heidi Van Arnem Foundation to Cure
Paralysis, Birmingham, MI
Help & Information Service, Long Pond,
PA
Help Enable Alcoholics Receive
Treatment Inc., Metairie, LA
Help of Tampa Bay Inc., Pinellas Park,
FL
Help With Hearing Foundation, San
Antonio, TX
Helping Enhance Lifes Potentials, Dallas,
TX
Historically Black Colleges and
University Association, Kansas City,
MO
Hmong American Association of Portage
County Inc., Stevens Point, WI

Hope Housing, Crystal Lake, IL
Hope Unity & Growth Inc., Detroit, MI
Hopkins Street Community Association
LTD, Milwaukee, WI

If an organization listed above submits information that warrants the renewal of its classification as a public charity or as a private operating foundation, the Internal Revenue Service will issue a ruling or determination letter with the revised classification as to foundation status. Grantors and contributors may thereafter rely upon such ruling or determination letter as provided in section 1.509(a)-7 of the Income Tax Regulations. It is not the practice of the Service to announce such revised classification of foundation status in the Internal Revenue Bulletin.

Definition of Terms

Revenue rulings and revenue procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified*, below).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it ap-

plies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in law or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in the new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the

new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified* and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A—Individual.
Acq.—Acquiescence.
B—Individual.
BE—Beneficiary.
BK—Bank.
B.T.A.—Board of Tax Appeals.
C.—Individual.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
CI—City.
COOP—Cooperative.
Ct.D.—Court Decision.
CY—County.
D—Decedent.
DC—Dummy Corporation.
DE—Donee.
Del. Order—Delegation Order.
DISC—Domestic International Sales Corporation.
DR—Donor.
E—Estate.
EE—Employee.

E.O.—Executive Order.
ER—Employer.
ERISA—Employee Retirement Income Security Act.
EX—Executor.
F—Fiduciary.
FC—Foreign Country.
FICA—Federal Insurance Contribution Act.
FISC—Foreign International Sales Company.
FPH—Foreign Personal Holding Company.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
FX—Foreign Corporation.
G.C.M.—Chief Counsel's Memorandum.
GE—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
I.R.B.—Internal Revenue Bulletin.
LE—Lessee.
LP—Limited Partner.
LR—Lessor.
M—Minor.
Nonacq.—Nonacquiescence.
O—Organization.
P—Parent Corporation.

PHC—Personal Holding Company.
PO—Possession of the U.S.
PR—Partner.
PRS—Partnership.
PTE—Prohibited Transaction Exemption.
Pub. L.—Public Law.
REIT—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Proc.—Revenue Ruling.
S—Subsidiary.
S.P.R.—Statements of Procedural Rules.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D.—Treasury Decision.
TFE—Transferee.
TFR—Transferor.
T.I.R.—Technical Information Release.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
U.S.C.—United States Code.
X—Corporation.
Y—Corporation.
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